NOTES

Group Rates: A Questionable Feature of the Railroad Rate Structure

A practice long used by the railroads in rate-making is the establishment of "group" or "blanket" rates.[1] A group rate is established by treating variously located producers or various localities as if they were all situated at the same place, thus making freight charges identical for all. Where the area included in the group is extremely large, the resultant rate is usually referred to as a "blanket" rate.[2] At one time, for example, the entire area east of the Rockies was given a "blanket rate" on certain shipments to the West Coast.[3] The coal mines of Illinois, on the other hand, divided into numerous rate groups,[4] exemplify the more typical practice. The mere fact that several towns or producers are put into a rate group for one purpose does not mean they receive identical charges for all shipments to and from the group. For example, the fact that manufacturers may be put into a single rate group for the shipment of their finished product to markets does not mean that identical charges necessarily will be made on shipments of raw materials to them. The group may exist only for purposes of shipments out of it,[5] or into it,[6] or even only out of it in a certain direction.[7] The important thing is that for the purpose for which the group rate is established, the relative geographic positions of the various points included in the group are disregarded, and charges for all shipments are computed on the basis of a central point within the group. In this respect, blanket or group rates are similar to basing point pricing systems under which freight charges for all sellers are computed from a single point, regardless of the actual distance of the buyer from the seller.[8] The basing point system has been subjected to attack by the Federal Trade Commission for a long time,[9] and more recently the Supreme Court has found that such pricing systems constitute discrimination within the meaning of Section 2 of the Clayton Act, as amended by the Robinson-Patman Act.[10] In view of this development, it is worthwhile to investigate why and to what extent the Interstate Commerce Commission has permitted the railroads to engage in a practice which results in price discrimination by depriving localities or manufacturers of their natural geographic advantages.

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1. For a general discussion of the problem, see SHARFMAN, THE INTERSTATE COMMERCE COMMISSION, Vol. B, pt. III, 656-691 (1936); LOCKLIN, ECONOMICS OF TRANSPORTATION 196-99 (3d ed. 1947).
2. LOCKLIN, *op. cit. supra* note 1, at 197.
3. *See* Railroad Commission v. Southern Pac. Co., 19 I. C. C. 238, 239 (1910).
4. *See* Coal to Beloit, Wisconsin, and Northern Illinois, 263 I. C. C. 179, 198 (1945).
5. *See* Howell v. New York, Lake Erie & W. R. R., 2 I. C. R. 162, 168 (1888).
6. *See* Avery Manufacturing Co. v. Atchison, T. & S. F. Ry., 16 I. C. C. 20, 23 (1909).
7. *See* Wisconsin & Ark. Lumber Co. v. St. Louis, I. M. & S. Ry., 33 I. C. C. 33, 49 (1915) (dissenting opinion).
8. For descriptions of basing point pricing systems, MACHLUP, THE BASING-POINT SYSTEM 1-30 (1949); *see* FTC v. Cement Institute, 333 U. S. 683, 696-699 (1948).
9. A brief history of the FTC's attack on the basing point system is given in Corn Products Refining Co. v. FTC, 324 U. S. 726, 735-6 (1945).
10. 38 STAT. 730 (1914), as amended, 49 STAT. 1526 (1936), 15 U. S. C. § 13 (1946); FTC v. Cement Institute, 333 U. S. 683 (1948); Corn Products Refining Co. v. FTC, 324 U. S. 726 (1945); FTC v. Staley Manufacturing Co., 324 U. S. 746 (1945).

Development of Group Rates

The use of group or blanket rates pervades our railroad rate structure.[11] An extreme example of its current application is found in the blanketing of the entire area east of Chicago and Cincinnati for shipments of citrus fruits from California.[12] This means that a California shipper can send oranges to New York City for the same charges as to a point just east of Chicago, approximately 900 miles nearer California. For many years, likewise, most of Texas received one blanket rate on shipments into it, so that a shipper outside Texas could send goods to almost any place in the state for the same charge.[13] More usually a group covers a much smaller area and joins all producers of a single product in a given region, or in several towns which distribute to a common surrounding territory. It is the almost universal practice to group coal mines this way;[14] and similar groupings, for example, are found among potato growers,[15] lumber mills,[16] and lime kilns.[17]

Various reasons can be given to explain the adoption of group rates by railroads. First, it is a method of simplifying tariff schedules;[18] by using rate groups, the railroads are able to avoid the difficulty of having to compute the distances and charges for each point within the group. Very often, again, group rates can be explained as a result of carrier competition to carry the traffic to or from a particular region. An illustration of this lies in the development of transcontinental rail rates. The earliest transcontinental lines originated on the east coast. On shipments from the east coast, water carrier competition kept rates low, but since there was no such competition from inland points, the transcontinental rates from inland points were computed by adding the rail rate from the point of origin to the east coast, to the rate from the east to the west coast. Accordingly, during this period, rates on shipments to the west coast increased as one moved westward. Then, with the construction of transcontinental lines originating in the middle west, during the 1880's, pressure developed for the adoption of rates based on distance. Otherwise, as long as rates were lower from the east than from the middle west, the bulk of the traffic would originate in the east. The adoption of rates graduated from east to west followed. In 1894, however, a violent rate war broke out between the eastern railroads and the water carriers, driving the transcontinental rates down drastically. At the same time the eastern rail carriers were faced with the competition from mid-western lines for traffic originating from inland points. The consequence was an agreement of all the carriers, in 1898, to the establishment of a blanket

11. *See, e.g.,* Eastern Class Rate Investigation, 164 I. C. C. 314, 323 (1930).

12. *Hearings before Subcommittee on Trade Policies of the Senate Committee on Interstate and Foreign Commerce on S. R. 241,* 80th Cong., 2d Sess. (1948); Arlington Heights Fruit Exchange v. Southern Pac. Co., 22 I. C. C. 149 (1911).

13. *See* Dallas Freight Bureau v. Missouri, K. & T. Ry., 12 I. C. C. 427, 429 (1907).

14. *See* Coal to Beloit, Wisconsin, and Northern Illinois, 263 I. C. C. 179, 198 (1945).

15. *See* Scott v. Cape Charles R. R., 38 I. C. C. 467, 471 (1916).

16. *See* Connor Lumber and Land Co. v. Akron, C. & Y. Ry., 40 I. C. C. 111, 112 (1916).

17. *See* Waukesha Lime & Stone Co. v. Chicago, M. & S. P. Ry., 26 I. C. C. 515, 518 (1913).

18. *See* Commodity Rates on Lumber and Other Forest Products, 165 I. C. C. 561, 568 (1930); Locklin, Economics of Transportation 198 (3d ed. 1947).

rate on shipments to the west coast from all points east of the Mississippi River.[19] Similarly, carrier competition for traffic to various towns which distributed goods throughout a common area was settled by adoption of the same rate to all the towns involved. This explains the establishment of Texas as one rate group.[20]

Another cause of grouping was the adoption of Section 4 of the Interstate Commerce Act,[21] which prohibited charging more for a short haul than for a longer one over the same line. Prior to its adoption, points served by two or more railroads had, in many cases, received lower charges, because of carrier competition to carry goods to those points, than intermediate points closer to the shipping point which were served by only one of the railroads. After the adoption of Section 4, the railroads often gave the intermediate points, which had previously paid more, the same rate as more distant points at which there was competition, with the result that a rate group was formed.[22] Rate groups were also initiated by railroads to encourage the location of particular types of industry along their lines. A carrier would make the same freight charge to a common market, for new manufacturers locating their plants along its lines, as it made for manufacturers of like products already located there, even though the new plants were more distant from the market.[23] Similarly, carriers would extend their lines into new coal or other natural resource regions and encourage development of the mines all along the line, rather than only those closest to the market, by making the same freight charge to the market for all.[24]

The Interstate Commerce Commission's Attitude Toward Group Rates

From its very inception the Interstate Commerce Commission has been confronted with the problem of group rates. Its early decisions established the proposition that group rates were not illegal per se, but were open to attack in every instance and would be eliminated if complainants could make a proper showing of damages.[25] Adhering to this policy, the Commission has continued to allow the railroads to establish group rates. It has, however, consistently refused to initiate them [26] and has occasionally refused to compel a railroad to maintain a group rate which the railroad desired to discontinue.[27] This somewhat inconsistent position can be explained by the Commission's policy, enforced by the

19. Jones, Principles of Railway Transportation 166-171 (1925); *see* Business Men's League v. Atchison, T. & S. F. Ry., 9 I. C. C. 318, 323 (1902).

20. *See* Dallas Freight Bureau v. Missouri, K. & T. Ry., 12 I. C. C. 427, 429 (1907).

21. 24 Stat. 80 (1887), 49 U. S. C. § 4 (1) (1946).

22. Locklin, Economics of Transportation 198 (3d ed. 1947); Texas & Pac. Ry. v. I. C. C., 162 U. S. 197 (1896) (holding that § 4 does not prohibit like rates for hauls of different distances); *see* Howell v. New York, L. E. & W. R. R., 2 I. C. C. 162, 173 (1888).

23. *See* Whiterock Quarries, Inc. v. Pennsylvania R. R., 266 I. C. C. 157, 163 (1946); Vanderblue & Burgess, Railroads 151 (1923).

24. Healy, The Economics of Transportation 240 (1940).

25. Howell v. New York, L. E. & W. R. R., 2 I. C. R. 162, 174 (1888).

26. *See, e. g.,* International Agricultural Corp. v. Louisville & N. Ry., 22 I. C. C. 488, 494 (1912); Arlington Heights Fruit Exchange v. Southern Pac. Co., 22 I. C. C. 149, 156 (1911). *Contra:* Anaconda Copper Mining Co. v. Director General, 78 I. C. C. 549 (1923), *rev'd on reargument,* 144 I. C. C. 433 (1928).

27. Lumber Between Points in Official Territory, 214 I. C. C. 493, 523 (1936).

courts,[28] of refusing to regulate economic conditions deliberately under the guise of rate making.[29] For the Commission to require railroads to charge all shippers in a certain area the same amount on shipments to the same point, regardless of the differences in distances of the various shippers, would be economic regulation. The carriers regulate economic conditions when they establish a group rate, but their act has been justified as an effort of each railroad to increase its traffic by enabling shippers along its line to meet the market prices of other sellers in a given market.[30] The Commission, therefore, has classified grouping as a bona fide method of increasing a railroad's business, taking it outside the prohibition against regulating rates to equalize economic conditions.[31] Furthermore, the Commission's fundamental concern in this field has been with discrimination. The Commission could hardly find that a refusal to make the same charge for hauls of varying length constituted discrimination and required replacement by a group rate,[32] but it is readily arguable that a carrier-created group rate does not constitute the undue discrimination prohibited by the Act.[33]

The Commission's approval of group or blanket rates has been influenced by other considerations. Probably the most influential one is that group rates allow more producers to enter a given market on a basis of apparent equality with the result that competition is promoted.[34] It is here that advocates of the basing point system and proponents of group rates join forces.[35] The Commission also feels that the increased sources of supply made available by a group rate are desirable for consumers, because, with numerous sources, consumers will be damaged less if one source becomes temporarily unavailable.[36] Grouping has been treated as particularly applicable to areas containing natural resources,[37] as a method of enabling a general development of the entire area rather than only that part of it which is most advantageously located in relation to the market. This consideration, however, seems more closely related

28. *See, e. g.*, I. C. C. v. Diffenbaugh, 222 U. S. 42, 46 (1911).

29. *See, e. g.*, Elk Cement and Lime Co. v. Baltimore & Ohio R. R., 22 I. C. C. 84, 88 (1911).

30. Dutton Lumber Corp. v. New York, N. H. & H. R. R., 151 I. C. C. 391, 412 (1929); Bituminous Coal to Central Freight Association Territory, 46 I. C. C. 66, 119 (1917); Cast Iron Pipe from North Carolina Points, 38 I. C. C. 183, 186 (1916); SHARFMAN, *op. cit. supra* note 1, at 656.

31. Lake, *Discrimination by Railroads and Other Public Utilities—Preferences to Patrons in a Given Locality*, 25 N. C. L. REV. 273, 276 (1947).

32. Anaconda Copper Mining Co. v. Director General, 144 I. C. C. 443, 446-447 (1928).

33. *See, e. g.*, Bituminous Coal to Central Freight Association Territory, 46 I. C. C. 66, 119 (1917); Waukesha Lime & Stone Co. v. Chicago, M. & S. P. Ry., 26 I. C. C. 515, 518 (1913); Desel-Boettcher Co. v. Kansas City So. Ry., 12 I. C. C. 221, 222 (1907).

34. *See, e. g.*, Wisconsin and Ark. Lumber Co. v. St. Louis, I. M. & S. Ry., 33 I. C. C. 33, 38 (1915); Waukesha Lime & Stone Co. v. Chicago, M. & S. P. Ry., 26 I. C. C. 515, 518 (1913); Kansas City Transp. Bur. v. Atchison, T. & S. F. Ry., 16 I. C. C. 195, 203 (1909); Fetter, *The Economic Law of Market Areas*, 38 Q. J. ECON. 520, 523 (1924).

35. SOME FACTORS IN THE PRICING OF STEEL 25 (TNEC Monograph 42, 1941); SEN. REP. No. 27, 81st Cong., 1st Sess. 9-12 (1949). In this report, the position of the Interstate Commerce Commission approving group rates is cited as directly contrary to the Federal Trade Commission's arguments that competition is promoted by f. o. b. pricing.

36. Iron Ore Rate Cases, 41 I. C. C. 181, 216 (1916); *see, e. g.*, Howell v. New York, L. E. & W. Ry., 2 I. C. C. 162, 174 (1888).

37. *See* Wisconsin & Ark. Lumber Co. v. St. Louis, I. M. & S. Ry., 33 I. C. C. 33, 37-38 (1915).

to conservation than it does to regulation of railroads. The fact, also, that vested interests have been built up in reliance on a group rate and would be damaged by its termination has been a very important consideration influencing the Commission to continue an existing group rate when it is challenged.[38] Finally, group rates have been justified as a necessary method of simplifying the tariff structures of railroads,[39] even where those structures are founded basically on the distance principle.[40]

Although the general attitude of the Commission seems to be that group rates are such a well established feature of the rate structure that their general propriety can hardly be challenged,[41] any particular group is still open to challenge. The general standard applied by the Commission in determining the legality of a rate group is that the group must not unduly discriminate against interested parties.[42] In determining whether there is undue discrimination the Commission looks primarily at two considerations: first, the size of the group in relation to the length of the haul;[43] second, positive injury suffered by the complaining party.[44]

As a general proposition, it may be said that the longer the haul the larger the size of the group may be.[45] This follows from the fundamental principle of railroad rate making that as the length of the haul increases the cost per mile declines.[46] Differences in distance which are small in proportion to the total distance carried, will make only a small variation in the cost of the freight bill. Where the difference in the freight bill which is eliminated by the group rate is small, there is less reason for the Commission to find that the rate unduly discriminates against the shipper who is deprived of his geographical advantage. The Commission has, on several occasions, laid down standards as to how large a group can be in relation to the length of the haul. *In Western Trunk Lines Class Rates,*[47] for example, the Commission ruled that both origin and destination groups not exceeding 30 miles in diameter were permissible, provided the base points[48] in each group were at least 400

38. *See, e. g.,* Federated Metals Corp. v. Pennsylvania R. R., 161 I. C. C. 287, 288 (1930); Bituminous Coal to Central Freight Association Territory, 46 I. C. C. 66, 143 (1917); Kansas City Transp. Bur. v. Atchison, T. & S. F. Ry., 16 I. C. C. 195, 203 (1909).

39. *See* Commodity Rate on Lumber and Other Forest Products, 165 I. C. C. 561, 568 (1930).

40. *Ibid.*

41. The New York Harbor Case, 47 I. C. C. 643, 712 (1912).

42. *See* Bituminous Coal to Central Freight Association Territory, 46 I. C. C. 66, 119 (1917); Waukesha Lime & Stone Co. v. Chicago, M. & S. P. Ry., 26 I. C. C. 515, 518 (1913); Southwestern Missouri Miller's Club v. Missouri, K. & T. Ry., 22 I. C. C. 422, 424-25 (1912); Black Mountain Coal Land Co. v. Southern Ry., 15 I. C. C. 286, 292-3 (1909); Desel-Boettcher Co. v. Kansas City So. Ry., 12 I. C. C. 221, 222 (1907).

43. Grain and Products, Oregon, Idaho, Utah to Pacific Coast, 268 I. C. C. 707, 728-9 (1947); Arkansas Rice Traffic Bureau v. Aberdeen & Rockfish R. R., 219 I. C. C. 5, 52-3 (1936); Livestock—Western District Rates, 176 I. C. C. 1, 85 (1931); Mitchell v. Atchison, T. & S. F. Ry., 12 I. C. C. 325, 326 (1907).

44. Mason City Brick & Tile Co. v. Chicago, M. S. P. & A. R. R., 258 I. C. C. 312, 313 (1944); Southwest Virginia Lime Producers Ass'n v. Aberdeen & Rockfish R. R., 218 I. C. C. 189, 194 (1936); Graff-Kittanning Clay Products Co. v. Atlantic City R. R., 218 I. C. C. 765, 773 (1936); Bradley & Woertz v. Illinois Cent. R. R., 118 I. C. C. 233, 235 (1926); Howell v. New York, L. E. & W. R. R., 2 I. C. R. 162, 175 (1888).

45. Cases cited note 43 *supra.*

46. Healy, The Economics of Transportation 209 (1940).

47. 164 I. C. C. 1 (1930).

48. The "base point" in a group is that point from which rates for the group are computed.

miles apart, and that origin and destination groups of 50 miles in diameter were proper if the base points were 800 miles apart.[49] On another occasion the test established was that the diameter of a group should not exceed 10% of the distance from the nearest point in the group to the destination in question.[50] Such standards are not rigidly adhered to,[51] although, for the most part, groups approved do not exceed them.

It is a fundamental requirement for a successful attack on a group that the complainant make a showing of positive injury.[52] Where the market is sufficiently large to absorb the output from the entire group, the Commission has seldom found injury to the nearer producers which would justify elimination of the group rate.[53] The test apparently applied is not whether the nearer producers would have been able to do more business without the rate group, but rather whether it reduced their existing absolute business or proportionate share of the total business.[54] If nearer producers have only been able to take a small part of a large increase in business, or have suffered a decline in business, their injury may be sufficient to justify alteration or elimination of the group.

There are various other less important considerations influencing the Commission in any action on a group rate. Where the group rate is established "for a single industrial unit," the Commission is more likely to give its approval.[55] An area constitutes a single unit when the producers within it produce like products and compete with one another. On this basis, Dallas, Forth Worth, and Denton, Texas for example, have been included in a single group,[56] as have also St. Paul and Minneapolis, and Duluth and Superior.[57] The fact that a group rate is of long standing will also be influential with the Commission,[58] although it has consistently maintained that the mere fact does not make it lawful.[59] A related consideration is that where the group rate is a part of a carefully adjusted set of rate relationships which may be disturbed by a rearrangement of the group, the Commission will be less willing to change it than otherwise.[60] Finally, the Commission often has placed considerable reliance on testimony of both shippers and carriers that they approve the arrangement.[61]

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49. Western Trunk Line Class Rates, 164 I. C. C. 1, 198 (1930).
50. Livestock—Western District Rates, 176 I. C. C. 1, 86 (1931).
51. *See* Livestock—Western District Rates, 176 I. C. C. 1, 89 (1931).
52. See SHARFMAN, *op. cit. supra* note 1, at 674; cases cited note 48 *supra*.
53. *See* Howell v. New York, L. E. & W. R. R., 2 I. C. R. 162, 175 (1888).
54. *See* Whiterock Quarries, Inc. v. Pennsylvania R. R., 266 I. C. C. 157, 163 (1946); Milk Producers' Protective Association v. Delaware, L. & W. R. R., 7 I. C. C. 92, 166 (1897).
55. *See* Consolidated Southwestern Cases, 211 I. C. C. 575, 588 (1935); Western Trunk Line Class Rates, 164 I. C. C. 1, 197 (1930).
56. Consolidated Southwestern Cases, 211 I. C. C. 575, 588 (1935).
57. Western Trunk Line Class Rates, 164 I. C. C. 1, 197 (1930).
58. *See* Graff—Kittanning Clay Products Co. v. Atlantic City R. R., 218 I. C. C. 765, 773 (1936); Federated Metals Corp. v. Pennsylvania R. R., 161 I. C. C. 287, 288 (1930); Bituminous Coal to Central Freight Association Territory, 46 I. C. C. 66, 143 (1917).
59. See SHARFMAN, *op. cit. supra* note 1, at 668.
60. *See* Southwest Virginia Lime Producers' Ass'n v. Aberdeen & Rockfish R. R., 218 I. C. C. 189, 194 (1936).
61. *See* Whiterock Quarries, Inc. v. Pennsylvania R. R., 266 I. C. C. 157, 164 (1946); Cotton, Woolen, & Knitting Factory Products, 211 I. C. C. 692, 779 (1935); Livestock—Western District Rates, 176 I. C. C. 1, 85 (1931); Bituminous Coal to Central Freight Ass'n Territory, 46 I. C. C. 66, 143 (1917); Southwestern Missouri Millers' Club v. Missouri K. & T. Ry., 22 I. C. C. 422 (1912).

ARE GROUP RATES DESIRABLE?

The obvious objection to group rates is that they deprive the favorably located producer of his advantageous location. The nearer producer pays a higher freight charge so that the more distant producer can pay less. In simple terms, assuming that the carrier makes only an adequate return on the total traffic from the group, the result of group rates is that the nearer producer subsidizes the more distant one. It means that the carrier collects something analogous to "phantom freight" on the hauls from the closer points and does the equivalent of "absorbing freight" [62] on the longer hauls. If the existing demand could be satisfied by more intensive use of the nearby facilities, or by the location of more producers in the nearby areas, the adoption of a group rate will result in a higher consumer price, measured by the amount of additional freight which must be paid because producers have not been forced to locate themselves naturally in the most advantageous spot in relation to the market. Grouping protects the uneconomically located producer.[63]

"Cross hauling" is another evil which may result from group rates.[64] Because of like transportation costs, if f. o. b. prices are identical, purchasers will not necessarily buy from the producer located nearest them. This results in cross shipment of the same product, and adds needlessly to the total freight bill which must be paid by the nation.

The main argument of the Commission for its support of group rates is that if it were not for grouping, nearby producers would acquire a natural monopoly.[65] This contention overlooks various considerations which seriously impair its validity. First, it is based on the erroneous assumption that all producers' costs are the same. To the extent that more distant producers operate at costs below those who are nearer, they can absorb an increase in freight and continue to compete. Similarly, other producers can absorb an increase in freight rates by accepting profits below the general level. And even if all manufacturers have equal costs, the nearby producer's advantage is limited by the potential competition which will enter the field if his prices and profits become excessive. Nor will grouping always successfully place all competitors on an equal basis.[66] If one producer, located nearer the raw materials used, and another, located nearer the market, are both put in the same group for purposes of shipments to the market, the producer nearer the raw materials is given an artificial advantage over the one nearer the market.[67] Again, the producer nearer the market may have paid a higher price for his property than the more distant producer.[68]

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62. "Phantom freight" is collected under a basing point pricing system where the point from which goods are actually shipped is closer to their destination than the point from which the freight charge is computed, *i. e.*, the basing point. Freight is "absorbed" where the reverse is true, *i. e.*, where the basing point is closer to the destination than the point of actual shipment. For a brief explanation, see FTC v. Cement Institute, 333 U. S. 683, 696-699 (1948).

63. SHARFMAN, *op. cit. supra* note 1, at 690-691.

64. LOCKLIN, *op. cit. supra* note 1, at 190.

65. *See* Graff—Kittanning Clay Products Co. v. Atlantic City R. R., 218 I. C. C. 765, 773 (1936); Wisconsin & Arkansas Lumber Co. v. St. Louis, I. M. & S. Ry., 33 I. C. C. 33, 37 (1915); Waukesha Lime & Stone Co. v. Chicago, M. & S. P. Ry., 26 I. C. C. 515, 518 (1913); Kansas City Transp. Bur. v. Atchison, T. & S. F. Ry., 16 I. C. C. 195, 203 (1909); LOCKLIN, *op. cit. supra* note 1, at 190.

66. *See* Dutton Lumber Corp. v. New York, N. H. & H. R. R., 151 I. C. C. 391, 418-19 (1929) (Comm'r Eastman dissenting).

67. *Ibid.*

68. *Ibid.*

It is always argued that since business and commerce have developed in reliance on group rates, they should be preserved, since any change in the system would do much harm. The Commission has frequently given expression to this attitude,[69] in spite of the fact that it has announced that no rate becomes proper solely because it has been in existence for a long time.[70] Group rates gain no validity from such an argument: at best it is only a reason why the Commission should deal with the problem in a conservative manner.

Would Elimination of Group Rates Constitute Economic Regulation by the Commission?

Through rate regulation both the Commission and the railroads, which normally initiate rates in the first instance,[71] necessarily exercise a large measure of control over our economic structure.[72] As part and parcel of this, whatever policy the Commission adopts toward group rates will have some effect on our economy, and becomes, therefore, at least in part a question of economic policy. Since the Commission has not condemned group rates up to now, a change of attitude might be regarded as primarily aimed at regulating economic conditions instead of railroad rates, and to this both the Commission[73] and the courts[74] are opposed. Supporters of group rates argue that by eliminating them, the Commission would determine that producers heretofore enabled to compete shall no longer be able to do so, and this, it would be urged, is prohibited economic regulation.

Such a view was adopted in *Anchor Coal Co. v. United States.*[75] That case involved railroad rates from coal mining groups in Pennsylvania, Ohio and West Virginia to the Great Lakes ports. Originally, the rates established by the carriers had not reflected the distances of the various groups from the ports, in order that the more distant West Virginia mines might compete with the nearer ones. Under this differential the West Virginia mines prospered, while the nearer mines lost business. The Commission ordered lower rates from the nearer groups to establish a relation between the nearer and more distant mines more nearly reflecting the differences in distance. It then refused to allow the railroads hauling coal from the more distant West Virginia mines to lower their rates to restore the old ratio. The Court held that this was an improper economic determination by the Commission.

On examination, however, the contention seems specious. The original purpose of Congress in enacting the Interstate Commerce Act was to prevent undue discrimination between shippers.[76] It would be logical

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69. Cases cited note 38 *supra.*
70. See note 63 *supra.*
71. Berge, *The Rate Making Process,* 12 LAW AND CONTEMP. PROB. 449 (1947).
72. Comment, 40 YALE L. J. 600 (1931).
73. *See* Connor Lumber & Land Co. v. Akron C. & Y. Ry., 40 I. C. C. 111, 112 (1916); Elk Cement & Lime Co. v. Baltimore & Ohio R. R., 22 I. C. C. 84, 88 (1911).
74. *See, e. g.,* I. C. C. v. Diffenbaugh, 222 U. S. 42, 46 (1911).
75. Anchor Coal Co. v. United States, 25 F. 2d 462 (S. D. W. Va. 1928), *rev'd on other grounds,* 279 U. S. 812 (1929). See Lake, *Discrimination by Railroads and Other Public Utilities—Preferences to Patrons in a Given Locality,* 25 N. C. L. REV. 273, 287 (1947).
76. I. C. C. v. Baltimore & Ohio R. R., 145 U. S. 263 (1892). Section 2 of the Interstate Commerce Act, 24 STAT. 379 (1887), 49 U. S. C. §2 (1946), makes it unlawful for a carrier to "directly or indirectly . . . charge, demand, collect, or re-

for the Commission to find that rates designed to deprive favorably located producers of their geographic advantage constituted undue discrimination. Their elimination would be in accord, therefore, with the purpose of the Act. But more than that, grouping of various points involves a conscious economic judgment on the part of the railroads. It is an arbitrary railroad determination of economic policy which the Commission has been allowing. Rejection of the principle of group rates and imposition of a distance principle would eliminate third party determination of who should compete in a given market and allow the producers themselves to determine that question when they choose their location. Such a step would be economic regulation only in the sense that it removes power from the carriers to disturb the natural adjustment of freely competitive producers. The Commission would really be preventing private economic regulation, not imposing any of its own.

CONCLUSION

There are no reliable indications that group rates can be successfully challenged in the courts. In *Ayrshire Collieries Corp. v. United States*,[77] the Supreme Court held recently that it was proper for the Commission to determine that undue discrimination resulted merely from the fact that carriers were granting lower rates to some points within a well-established rate group, without any showing that the rate differential was unrelated to distance. The Court recognized the long history of rate grouping, and the Commission's continued support of groups as a means of equalizing competition. It found that the Commission was justified in considering the element of competition in establishing rate differentials. Finally, it specifically left open the question of the legality of the entire process of rate making on a group basis.

The impact of the case would appear to be two-fold. It clearly displays the unwillingness of the Court to enter into a technical analysis of the correctness of the Commission's decisions as to the composition of specific groups and the desirability of rate differentials between specific groups. More interestingly, it seems to grant that the Commission may make a certain amount of economic regulation an integral part of its rate making activities. Certainly there is nothing in the opinion which denies the right of the Commission to reverse its sympathetic attitude toward group rates in favor of a more rigorous application of the distance principle. In view of the marked emphasis placed by the opinion on the fact that the case did not involve any general challenge to rate grouping as a system of rate making, there may be something in the wind. The similarity of rate grouping to the basing point system recently disapproved by the Court in the *Cement* case[78] lends some support to this view.

ceive from any person or persons a greater or less compensation for any service rendered, or to be rendered . . . than it charges, demands, collects, or receives from any other person or persons for doing him or them a like and contemporaneous service . . ." Section 3(1), 24 STAT. 380 (1887), as amended, 41 STAT. 479 (1920), 49 U. S. C. § 3(1) (1946), makes it "unlawful for any common carrier . . . to make, give, or cause any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, association, locality, port, port district, gateway, transit point, region, district territory, or any particular description of traffic in any respect whatsoever; or to subject [them] . . . to any undue or unreasonable prejudice or disadvantage in any respect whatsoever. . . ."

77. 335 U. S. 573 (1949).

78. FTC v. Cement Institute, 333 U. S. 683 (1948).

That it is not to be depended upon, however, is evidenced by a later district court decision which rejected the argument that group rates are illegal per se.[79]

Recent testimony in connection with proposed legislation to legalize the basing point pricing system shows that currently the position of the Commission on group rates is somewhat confused.[80] Chairman Mahaffie appeared on behalf of the Commission in opposition to a section of the bill [81] which he feared would *compel* the Commission to promote competition. He stated that the Commission always considered competition when fixing rates, and took a conservative policy toward disrupting rate relations which had sprung from competition, but he denied that the Commission had any general policy of promoting competition through rate making. Furthermore, he said that any application of the principle of promoting competition by rate regulation is subject to certain limitations which prevent its use to promote wasteful competition, to give undue preferences as between competing shippers, or to deprive parties of natural geographic advantages! It is difficult to reconcile this statement of principles with the approval which the Commission continues to give to group rates.[82]

For the most part, the Commission has relied on the distance principle in its promotion of a national rate structure,[83] so as to place shippers and receivers on a basis of practical equality uninfluenced by private motives. The Commission should reconsider the relation of rate grouping to this basic policy. Although the historical development of business in reliance on rate groups would prevent any violent change of policy, a start should be made now to get away from group rates in the future.

T. M. H., Jr.

Liabilities of the Transferor of Non-Negotiable Instruments Under the Proposed Commercial Code

The decisions regarding the liabilities of a transferor of non-negotiable commercial paper are a jungle of conflict, comparable to that which existed in the field of negotiable instruments prior to the enactment of the Nego-

79. Lynchburg Traffic Bureau v. United States, 84 F. Supp. 1012 (W. D. Va. 1949) (whether such rates were unjustly discriminatory held a question for the Commission, whose determination must be upheld unless unsupported by substantial evidence). Appeal to the Supreme Court was filed October 4, 1949.

80. *Hearings before the Senate Subcommittee on Trade Policies of Senate Committee on Interstate and Foreign Commerce on Sen. Bill 236,* 81st Congress, 1st Sess. (1949).

81. Section 1 of S. R. 241, 80th Cong., 2d Sess. (1948), in which it is stated to be a policy of the Federal Government, "(a) to develop a consistent and coordinated program of promoting competition, as affected by transportation costs, in interstate commerce, by the Federal Trade Commission, the Civil Aeronautics Board, the Post Office Department, and the Interstate Commerce Commission; (b) to foster competitive private enterprise by the treatment of transportation costs in interstate commerce so that access to distant markets may be available, when economically feasible, to any competing seller; (c) to encourage the Interstate Commerce Commission to continue and extend the policy of promoting regional and sectional competition by the establishment of appropriate transportation rates where required and in the best interests of the national economy."

82. SHARFMAN, *op. cit. supra* note 1, at 684.

83. Daggett, *Mileage Rates and the Interstate Commerce Commission,* 46 Q. J. ECON. 281 (1932).

tiable Instruments Law,[1] and which exists even today on a lesser scale.[2] Although the commercial importance of non-negotiable paper is dwarfed by that of negotiable instruments, the fact that there is a substantial amount of such paper in use in interstate transactions demonstrates the need for uniformity.[3] The proposed Uniform Commercial Code attempts to meet this need in part, by including within its purview all instruments which lack *words* of negotiability but meet all of the other requirements of negotiability.[4] All provisions of the Code relating to commercial paper are made applicable to such non-negotiable instruments, except that there can be no holder in due course.[5] This raises the interesting question of what changes are wrought by the Code on the common law of non-negotiable instruments, and to what extent it will clarify the law in this field.[6] This Note will attempt to analyze the problem with regard to the liabilities of the transferor of a non-negotiable instrument.

Before proceeding further, it is necessary to make a preliminary definition of "non-negotiable instrument." [7] The term includes more than instruments which lack only the requisite words of negotiability, but it does not include all choses in action which are not negotiable. A non-negotiable instrument, as the term is used here, is a sort of hybrid, possessing in use and form many of the characteristics of negotiable paper but lacking one or more of the formal requisites of negotiability. As will be shown, the courts have treated this hybrid as negotiable for some purposes and as a simple chose in action for others.

The liabilities of the transferor of such an instrument may generally be of two kinds, just as is the case with negotiable paper.[8] First, there is that liability which is incurred by virtue of an indorsement, by means of which the transferor adds his credit to that of the other obligors on the instrument. It is in the nature of a promise by the indorser, implied by law from his mere signing, that he will to some extent stand behind the instrument he is transferring. Secondly, there is the liability incurred by virtue of the transferor's status as a vendor, which takes the form of implied warranties by the transferor as to the nature of the instrument transferred. This latter is important only where there is no indorser liability.[9] Although the distinction is at times obscure in cases involving non-negotiable instruments, the two kinds of lability will be treated separately, since the distinction increases in importance under the Code. Finally, the feasibility of extending the Code provisions to non-negotiable instruments which have other defects than lack of words of negotiability will be considered.

1. Comment, 37 YALE L. J. 102 (1927).

2. Beutel, *Problems of Interpretation Under the Negotiable Instruments Law,* 27 NEB. L. REV. 485, 495 (1948).

3. A notable example is the type of long form note held non-negotiable in Overton v. Tyler, 3 Pa. 346 (1846), but which continues in widespread use.

4. UNIFORM COMMERCIAL CODE, art. III, § 805 (May, 1949 Draft) (hereinafter referred to as CODE).

5. *Ibid.*

6. For general discussion of the Code provisions on commercial paper see Leary, *Some Clarifications in the Law of Commercial Paper Under the Proposed Uniform Commercial Code,* 97 U. OF PA. L. REV. 354 (1949).

7. Goodrich, *Nonnegotiable Bills and Notes,* 5 IOWA L. BULL. 65 (1920).

8. *Cf.* NEGOTIABLE INSTRUMENTS LAW § 66.

9. *Cf.* Britton, *The Liability of a Transferor by Delivery and of a Qualified Indorser,* 42 YALE L. J. 25 (1932).

INDORSEMENT OF NON-NEGOTIABLE INSTRUMENTS

The liability of an indorser of *negotiable* instruments is based on the assumption, prompted by commercial need, that the indorser intended to lend his *complete* credit to the instrument transferred. Unless the indorser expressly limits his liability, the indorsement is considered a promise to pay the instrument if the primary obligor does not, provided requisite procedures are followed.[10] Whether the same policy of requiring an indorser to stand fully behind the paper he transfers should prevail in the field of non-negotiable paper depends upon whether the business need exists, even though the need for complete negotiability does not.

Many courts and text writers have recognized that a similar policy does exist with respect to non-negotiable paper, but there is confused disagreement as to the theoretical basis and the extent of the indorser's liability.[11] A favorite theory is that the indorsement is in effect the drawing of a new bill of exchange, and that the indorser should therefore be held to a liability greater than that of a mere assignor.[12] Another line of reasoning, often used in combination with the "new bill" theory, is that the instrument is "commercial paper," even though non-negotiable, so that the law merchant regarding indorsements applies.[13] This group of cases draws potency from English decisions on promissory notes following the Statute of Anne.[14] The Statute was enacted in order to bring promissory notes within the custom of merchants, after the courts refused to recognize them as having equal standing with bills of exchange.[15] Construing the Statute liberally, the courts held that it brought non-negotiable as well as negotiable notes within the purview of the law merchant.[16] The significant point is that, under both theories, the courts conclude that the indorser is something more than a mere assignor. A more direct and less confusing route to the same conclusion would be to determine from an examination of the instrument and the practices of the business community whether it is desirable to presume that an indorser in blank promises to stand behind the paper he transfers.

Nature of the Liability.—If it is concluded that an indorser of non-negotiable paper promises to stand behind the instrument, both theories lead to the proposition that liability is the same as if the instrument were negotiable. If the indorser is considered as the drawer of a new bill, under the law merchant he would be bound to pay the instrument upon presentment and notice of dishonor.[17] The result is the same under the theory that the transferor is an indorser of paper within the custom of merchants.[18] In view of the diversity of views at common law, however, it would be necessary in many instances to hold that the Negotiable Instruments Law applies in order to govern both types of paper by identical rules. The courts have not been willing to go so far,[19] and if the common law of negotiable instruments is applied to non-negotiable paper as well,

10. Broun v. Hull, 33 Gratt. 23 (Va. 1880); NEGOTIABLE INSTRUMENTS LAW § 66.
11. *See* Johnson v. Lassiter, 155 N. C. 47, 51, 71 S. E. 23, 25 (1911); STORY, PROMISSORY NOTES 133 (5th ed. 1859).
12. Leidy v. Tammany, 9 Watts 353 (Pa. 1840) (where court also likened the indorser to the maker of a new note).
13. De Haas v. Dibert, 70 Fed. 227 (3d Cir. 1895).
14. 3 & 4 ANNE, c. 9, § 1 (1704).
15. Buller v. Crips, 6 Mod. 29, 87 ENG. REP. 793 (Q. B. 1704).
16. Burchell v. Slocock, 2 Ld. Raym. 1545, 92 ENG. REP. 502 (K. B. 1728).
17. NEGOTIABLE INSTRUMENTS LAW § 61.
18. *Id.* § 66.
19. Reynolds v. Vint, 73 Ore. 528, 144 Pac. 526 (1914).

it often merely substitutes one set of confusion for another, especially with regard to irregular indorsers.[20] Partly as a result of these difficulties and partly because of the reluctance of courts to erase distinctions between negotiable and non-negotiable paper, only a few courts have carried their theory to the logical conclusion that an indorser of non-negotiable paper is bound to pay upon presentment and notice of dishonor.[21]

Some courts, having concluded that an indorser is bound to an extent greater than a mere assignor, hold that his position is that of an original promisor or surety.[22] Such a view holds the indorser of a non-negotiable instrument to a stricter liability than the indorser of negotiable paper, since the liability can be imposed without presentment or notice and without even due diligence to collect from the primary obligor.[23] This is manifestly inconsistent with any theory that the indorser is the drawer of a new bill, since the drawer is a secondary party entitled to due proceedings on dishonor, but to some extent it fits into the less popular view that an indorser of non-negotiable paper is the maker of a new note.[24]

A greater number of courts hold that the indorser is in effect a guarantor of collectibility, so that the indorsee is required to exercise due diligence to collect from the primary obligor before the indorser can be charged.[25] In such cases there is no necessity for formal presentment and notice, but due diligence requires a prompt suit against the primary obligor, unless suit is waived by the indorser, or would obviously be of no avail.[26] Some of these courts label the indorser an "assignor," and describe his liability as an implied warranty of the absence of defenses and of the solvency of the debtor.[27] The label is misapplied, since the general rule is that an assignor does not warrant the solvency of the debtor.[28] Moreover, the implied warranties of an assignor of a chose in action are imposed by virtue of the assignor's position as a vendor, without regard to any indorsement.[29] Hence, although these courts speak of implied warranties of an "assignor," they are really enforcing a contract of indorsement.

In all of these cases the real question is the extent to which an indorser of a non-negotiable instrument should be presumed to stand behind the paper he transfers, in the absence of any express limitation.[30] To determine this, it will not do to label the indorser a "surety," or "guarantor of collectibility," and then to allow the usual legal consequences of such status to ensue. All too often the result is that a conceptually-

20. *Cf.* Allen v. Brown, 124 Mass. 77 (1878); Elliot v. Moreland, 69 N. J. Law 216, 54 Atl. 224 (1903).

21. Haber v. Brown, 101 Cal. 445, 35 Pac. 1035 (1894); Helfer v. Alden, Cutter & Hull, 3 Minn. 332 (1859); Aldis & Gadcomb v. Johnson, 1 Vt. 136 (1828); *cf.* Quinn v. Rike, 50 Cal. App. 243, 194 Pac. 761 (1st Dist. 1920).

22. Nussear v. Hazard, 148 Md. 345, 129 Atl. 506 (1925); Persky v. Bank of America Nat. Ass'n, 261 N. Y. 212, 185 N. E. 77 (1933); Seymour v. Van Slyck, 8 Wend. 403 (N. Y. 1832).

23. See cases cited note 22 *supra.*

24. *See* Raymond v. Middleton & Co., 29 Pa. 529, 532 (1858); and note 12 *supra.*

25. Bank of Luverne v. Sharp, 152 Ala. 589, 44 So. 871 (1907); Piascyk v. Malon, 116 Conn. 418, 165 Atl. 352 (1933); Mazurkiewicz v. Dowholonek, 111 Conn. 65, 149 Atl. 234 (1930).

26. Ranson v. Sherwood, 26 Conn. 437 (1857); Merchants' Nat. Bank v. Spates, 41 W. Va. 27, 23 S. E. 681 (1895).

27. Merchants' Nat. Bank v. Spates, 41 W. Va. 27, 23 S. E. 681 (1895).

28. Maynard v. Maynard, 105 Me. 567, 75 Atl. 299 (1909).

29. See note 9 *supra* and text.

30. See Comment, 37 YALE L. J. 102, 105 (1927) for view stressing intent of the parties rather than commercial needs.

minded court overlooks the real commercial reason underlying indorser liability, namely, the need for promoting transferability of non-negotiable commercial paper. It is widely recognized, of course, that such a policy does exist, but there is very little agreement as to the extent to which the indorser should be bound.[31] This is due, no doubt, to the conflicting policy, so strong in the common law, of ascertaining and enforcing the actual intent of the parties. Carried to its extreme, the latter rule would make it necessary for the transferee to prove an actual agreement with the transferor that the latter would pay the instrument if the primary obligor did not;[32] the policy of commercial need, at the other pole, might demand an irrebuttable presumption that the indorser intended to make good the instrument if it were unpaid.[33] Many courts attempt to resolve the conflict by holding that the indorser liability, whatever its extent, is merely prima facie, and that the transferor may adduce parol evidence to prove that his contract was otherwise.[34] Such a view, although it may avoid hardship in some cases by ascertaining the actual agreement, prolongs and aggravates the doubt and confusion of the commercial world as to non-negotiable instruments.[35] It seems desirable, in view of modern conditions, that the policy of commercial necessity should prevail. In furtherance of that policy it is not unreasonable to require that the indorser expressly limit his liability in the indorsement, if such is his intent.

To Whom Liability Runs.—Irrespective of the nature of the liability of an indorser of non-negotiable paper, it is the prevailing view that it runs only to the immediate transferee.[36] Some cases, however, indicate that it may be shown that the intent of the parties was that liability should run to remote transferees.[37] The reasoning is that there is no "privity of contract" with any subsequent holders, and that it cannot be said, therefore, that the indorser made any promise as to them.[38] Since the indorser's name tends to increase the credit of the instrument even though there is no technical privity of contract, it would not be unjust to have the promise run to subsequent holders. Moreover, such a rule would further the commercial policy of promoting the transfer of non-negotiable instruments in any ways not inconsistent with their non-negotiable character. It is probably too great a step for the courts to make, but there seems no valid objection to a statutory rule making the indorser's promise run to subsequent transferees.[39] Here again, the transferor should expressly limit his liability if he wants to.[40]

As Mere Assignor.—Besides those jurisdictions which recognize indorser liability of some sort on non-negotiable paper, there is a strong minority that recognize no greater liability of the transferor than that of a mere assignor, the indorsement being considered no more than a

31. See note 11 *supra* and text.
32. See Comment, 37 YALE L. J. 102, 105 (1927).
33. *Cf.* NEGOTIABLE INSTRUMENTS LAW § 66. This policy of commercial convenience reigns supreme in negotiable instruments law.
34. Berry v. Gross, 192 Iowa 300, 184 N. W. 661 (1921); *cf.* Atkinson v. Bennett, 103 Ga. 508, 30 S. E. 599 (1898) (similar rule as to anomalous indorsers of negotiable instruments at common law).
35. In promoting long range stability, hardship in some cases is inevitable. See Chafee, *Acceleration Provisions in Time Paper,* 32 HARV. L. REV. 747, 750 (1919).
36. Kendall v. Parker, 103 Cal. 319, 37 Pac. 401 (1894); Raymond v. Middleton & Co., 29 Pa. 529 (1858). See also STORY, PROMISSORY NOTES 133 (5th ed. 1859).
37. Nuetzel v. Mackie, 80 Cal. App. 768, 253 Pac. 166 (3d Dist. 1927).
38. See cases cited note 36 *supra.*
39. *Cf.* CODE § 422.
40. *Cf.* CODE § 205.

means of assigning.[41] Since the assignor-indorser has not lent credit to the instrument by placing his name thereon, these cases really hold that there is no indorser liability *as such*.[42] Some of these cases do recognize, however, that the transferor may have intended to do more than merely assign, and admit extrinsic evidence to prove it.[43] If the emphasis is to be on carrying out the actual intent of the parties, rather than on business needs and practice, this view is reasonable. Even at that, however, it seems probable that a person placing his name on the back of commercial paper, negotiable or non-negotiable, usually anticipates that he will be made to pay if the primary obligor does not. In view of this likelihood, a rebuttable presumption in favor of indorser liability would sufficiently protect the exceptional transferor who intended nothing more than an assignment.[44]

The conceptual basis for holding that the indorser incurs no greater liability than that of a mere assignor is that there can be an "indorsement" in the law merchant sense only of *negotiable* instruments, and as to all other choses in action the law of assignments applies.[45] This argument assumes, of course, that only negotiable instruments were subject to the law merchant. Historically this is inaccurate, the notable example being non-negotiable promissory notes after the Statute of Anne.[46] If such mechanical reasoning were avoided, and attention paid instead to present business practice and needs, these courts would have to conclude that some instruments lacking a formal requisite of negotiability may nevertheless come within the law merchant as to indorser liability.

Under the Code.—By the inclusion within the Code of instruments lacking words of negotiability but having all the other formal requisites, some of the confusion with regard to non-negotiable instruments will undoubtedly be eliminated.[47] The Code does not adopt the majority common law view as to indorser liability, but it does recognize the majority common law policy that it is desirable to require the indorser of certain classes of non-negotiable paper to make good the instrument to some extent, unless he specifies to the contrary.[48] Accordingly, the indorser engages to pay the amount of the instrument to the holder *or any subsequent indorser* who takes it up, provided necessary proceedings on dishonor are taken.[49] Thus, under the Code an indorser stands *fully* behind his paper, unless he specifies otherwise, a minority view at common law.[50] With respect to the parties to whom the promise runs, the Code departs farthest from the common law which is that the promise runs only to the immediate transferee.[51] The result does not unduly erase the distinction between negotiable and non-negotiable instruments, since

41. Hayter v. Dinsmore, 125 Kan. 749, 265 Pac. 1112 (1928); Barger v. Farnham, 130 Mich. 487, 90 N. W. 281 (1902); Barnes v. Rowles, 84 Mont. 393, 276 Pac. 15 (1929).

42. But there is liability on the warranties of an assignor. RESTATEMENT, CONTRACTS § 175 (1932).

43. Steele v. Hudson, 30 Okla. 518, 120 Pac. 616 (1911).

44. See note 34 *supra* and text.

45. Pattee Plow Co. v. Beard, 27 Okla. 239, 110 Pac. 752 (1910).

46. See note 14 *supra* and text.

47. See Note, 79 A. L. R. 719 (1932).

48. CODE § 805.

49. CODE § 422.

50. The obvious way of specifying otherwise is by qualified indorsement. *Cf.* NEGOTIABLE INSTRUMENTS LAW § 38.

51. *Cf.* NEGOTIABLE INSTRUMENTS LAW § 66, under which the promise runs to all subsequent holders in due course.

even under the Code there can be no holder in due course of non-negotiable paper.[52]

WARRANTIES OF A TRANSFEROR

The other type of liability is that which the transferor of non-negotiable paper incurs by virtue of his status as a vendor, as distinguished from his liability as indorser.[53] Just as the vendor of a chattel is held to make certain implied warranties concerning the thing transferred, so the vendor of a chose in action makes certain implied warranties.[54] If the purchaser of a chose in action sues for breach of such warranties, his recovery is limited to the damages proved or the consideration paid.[55] Manifestly, the remedy is not so efficient as a suit on an indorser's promise to make good the instrument. As a result, the question of what implied warranties are made by one who indorses and delivers a non-negotiable instrument rarely arises in those jurisdictions where there is liability on the indorsement as such. In the case of negotiable instruments, the question arises only where proceedings on dishonor have been neglected or it is desired to bring suit before maturity of the instrument.[56] Where the indorser is considered a guarantor of payment the question does not arise, since there is no requirement of proceedings on dishonor or even of due diligence.[57] If due diligence were required to charge the indorser on his contract of indorsement, the same neglect which would preclude liability on the indorsement would probably preclude the liability on implied warranties.[58]

Where the indorser is held to be a guarantor of collectibility, the distinction between indorser liability and liability on implied warranties cannot be made sharply, since both types coalesce in the contract of indorsement. That is to say, the contract of the indorser to pay if the instrument is not collectible by due diligence, of necessity includes warranties that the instrument is genuine and not subject to undisclosed defenses, as well as a warranty that the primary obligor is solvent.[59] At any rate, the cases usually arise as actions on the contract of indorsement, where the transferee has not been able to collect because of a defense by the primary obligor, or because of his insolvency.[60]

As Mere Assignor.—The problem of implied warranties arises chiefly where the non-negotiable paper is transferred without indorsement, or by qualified indorsement, or where the jurisdiction holds that indorsement and delivery constitute merely an assignment. Inasmuch as a transfer by delivery is nothing more than an assignment,[61] and since a qualified indorsement ordinarily operates as an assignment,[62] the problem resolves itself into an inquiry as to the warranties of a mere assignor

52. *See* Berry v. Gross, 192 Iowa 300, 303, 184 N. W. 661, 662 (1921).
53. See note 9 *supra* and text.
54. Flynn v. Allen, 57 Pa. 482 (1868); Charnley v. Dulles, 8 W. & S. 353 (Pa. 1845).
55. Fergerson v. Staples, 82 Me. 159, 19 Atl. 158 (1889).
56. BRITTON, BILLS AND NOTES 1022 (1943).
57. See note 23 *supra* and text.
58. *Cf.* Lawrenceburgh Nat. Bank v. Stevenson, 51 Ind. 594 (1875).
59. Merchants' Nat. Bank v. Spates, 41 W. Va. 27, 23 S. E. 681 (1895).
60. See cases cited note 25 *supra*.
61. Gaines v. Fitzgibbons, 168 La. 260, 121 So. 763 (1929).
62. In some instances, parol evidence is admitted to determine the intent of the parties where indorsement of a non-negotiable instrument is "without recourse." Charnley v. Dulles, 8 W. & S. 353 (Pa. 1845); *cf.* NEGOTIABLE INSTRUMENTS LAW § 38.

of a non-negotiable instrument. The courts have not indicated that the liability of such an assignor is any different from that of an assignor of a simple chose in action, merely stating that he makes the warranties of an assignor.[63] This, of course, does not include those jurisdictions which impose an *indorser* liability which they simply label "implied warranties of an assignor." [64] The usual rule is that the assignor warrants that the instrument is genuine and what it purports to be.[65] Under this general rule, an assignor has been held to warrant that the chose in action is not usurious,[66] that it is not a forgery,[67] and that it is legally binding on the primary obligor.[68] Some courts speak of an implied warranty of solvency, but the usual rule is that the assignor does not warrant solvency by the mere act of assignment.[69]

Just as there appears to be no difference between the warranties of an assignor of non-negotiable paper and those of an assignor of an ordinary chose in action, so it appears that there is no marked difference between them and the warranties of an assignor of a negotiable instrument, although different language is sometimes used.[70] Since the basis for implied warranties is the sale for value, and is common to negotiable and non-negotiable choses alike, there seems to be no valid reason for making any distinction.[71] There is, however, a difference as to whom the warranties run. Generally, the warranties of an assignor run only to the immediate assignee, unless specifically extended to subsequent assignees.[72] Such was the rule as to negotiable instruments at common law; [73] it remains the law as to transfers of negotiable instruments by delivery.[74] But with regard to transfers by qualified indorsements, the Negotiable Instruments Law has extended the warranties to all subsequent holders.[75] Although this extension is justified as an aid to negotiability, the policy is by no means restricted to the field of negotiable instruments. In the field of sales law, also, the trend is to extend implied warranties to remote buyers.[76] Once we have recognized that the circulation of non-negotiable commercial paper should be facilitated in ways not inconsistent with its character of non-negotiability, the conclusion is inescapable that implied warranties should extend to remote transferees.

Under the Code.—With regard to the substance of the implied warranties of the transferor of non-negotiable paper, the Code, in effect, is a codification of the common law. But in respect to whom the warranties run, the Code makes a broad departure.[77] Unlike the Negotiable Instruments Law, however, the Code does not use the common law language

63. Newer v. First Nat. Bank, 74 Mont. 549, 241 Pac. 613 (1925) (under statute purporting to be a codification of the common law).
64. See note 27 *supra* and text.
65. Hayter v. Dinsmore, 125 Kan. 749, 265 Pac. 1112 (1928).
66. Tant v. Tant, 17 Gratt. 11 (Va. 1866).
67. Charnley v. Dulles, 8 W. & S. 353 (Pa. 1845).
68. Flynn v. Allen, 57 Pa. 482 (1868).
69. Giffert v. West, 33 Wis. 617 (1873); RESTATEMENT, CONTRACTS § 175 (2) (1932).
70. Hunt v. Sanders, 288 Mo. 337, 232 S. W. 456 (1921); Keller v. Hicks, 22 Cal. 457 (1863); *cf.* NEGOTIABLE INSTRUMENTS LAW §§ 65, 66; RESTATEMENT, CONTRACTS § 175 (1932).
71. 3 WILLISTON, CONTRACTS § 445 (rev. ed. 1936).
72. Weaver v. Beard & Bro., 21 Mo. 155 (1855).
73. Watson v. Chesire, 18 Iowa 202 (1865).
74. NEGOTIABLE INSTRUMENTS LAW § 65.
75. See BRITTON, BILLS AND NOTES 1020 (1943).
76. VOLD, SALES 474 (1931).
77. CODE § 421.

which caused so much difficulty in application. A favorite phrase of the common law was that an assignor warrants that the instrument "is genuine and what it purports to be." [78] The uncertainty of such a general standard is avoided by specifically stating that the transferor warrants against forgeries, material alterations, defective title, any defenses good against the transferor, and knowledge of any insolvency proceeding against the primary obligor.[79] In providing that the warranties run to the transferee or any subsequent holder in good faith the Code departs completely from the existing cases on non-negotiable instruments,[80] and makes the law fit business needs better thereby.[81]

Instruments Not Covered by the Code

At Common Law.—The Code extends its provisions only to those non-negotiable instruments which have all the formal requisites of negotiability except the words "to order" or "to bearer." [82] To that extent it will tend to make uniform the law of non-negotiable paper. There can be little argument against including such instruments in the Code, especially since they are often considered negotiable by the persons dealing with them, and because the words of negotiability are often omitted inadvertently.[83] But no court has *expressly* limited indorser liability on non-negotiable instruments to those whose only defect was omission of words of negotiability. On the contrary, many courts have imposed indorser liability on instruments non-negotiable for other reasons. Thus, some form or other of indorser liability has been imposed where the instrument was non-negotiable by reason of containing an acceleration clause,[84] or a provision for payment of taxes,[85] or where the instrument was under seal.[86] In most of these cases, the courts have not discussed the question of when a non-negotiable instrument comes within the rules as to indorser liability and when it is a simple contract subject to the law of assignments.[87] On the other hand, some courts have held that there is indorser liability on non-negotiable paper only if it is in the form of a bill or note.[88] In such cases the inquiry has not been primarily as to the negotiability of the instrument sued on, but whether the defect was so serious as to disqualify the instrument as even a non-negotiable bill or note. Accordingly, recovery against indorsers has been denied where the promise was conditional,[89] or not for a sum certain.[90] The effect of such a view is to limit indorser liability to instruments non-negotiable for lack of words of negotiability, since the other formal requisites of negotiability determine *also* whether the instrument is a bill or note.[91] Even

78. See note 65 *supra.*
79. Code § 421.
80. *Ibid.; cf.* note 72 supra.
81. See note 76 *supra* and text.
82. Code § 805.
83. For general discussion, see Goodrich, *Nonnegotiable Bills and Notes,* 5 Iowa L. Bull. 65 (1920).
84. Piascyk v. Malon, 116 Conn. 418, 165 Atl. 352 (1933).
85. Mazurkiewicz v. Dowholonek, 111 Conn. 65, 149 Atl. 234 (1930).
86. Helfer v. Alden, Cutter & Hull, 3 Minn. 332 (1859).
87. See cases cited notes 84-86 *supra.*
88. Smith v. First State Bank, 95 Minn. 496, 104 N. W. 369 (1905).
89. First Nat. Bank v. Lamoreaux, 255 Ill. App. 15 (1929).
90. Smith v. First State Bank, 95 Minn. 496, 104 N. W. 369 (1905).
91. See definition of bills and notes in 1 Daniel, Negotiable Instruments §§ 26, 27 (7th ed. 1933).

these courts, however, do not *expressly* limit the liability to the extent that the Code does.[92]

Neither of the prevailing approaches satisfactorily draws the line between non-negotiable instruments with indorser liability and simple contracts subject to the law of assignments. Those courts which have applied the rule of indorser liability without discussion of where the line should be cause much uncertainty; those which limit the rule to paper in the form of bills or notes preclude indorser liability on some important types of non-negotiable instruments, such as long form paper and non-negotiable certificates of deposit.[93] It has been suggested that the test should be whether the instrument in question is a "mercantile instrument," whatever that may be.[94] Ultimately, the question must turn on whether, as a matter of business practice and need, the *transfer* of the type of instrument under consideration should be *facilitated,* even though it lacks complete negotiability.[95] Sometimes there is a strong business reason for inserting a security provision that destroys negotiability.[96] Here the parties trade negotiability, the primary element of which is the cutting off of defenses upon transfer, for security. But it does not follow that the parties necessarily give up all transferability, and the fact that such instruments are usually issued in such form that they would be negotiable except for the offending provision, shows the business desire that they be as transferable as possible. If indorser liability is denied, transferability is greatly hindered, especially since the indorsee takes subject to defenses of the primary obligor.[97]

Effect of the Code.—The Code, as presently drafted, will by no means completely clarify the liability of the transferor of non-negotiable paper. It places some non-negotiable paper under the same rules as negotiable paper, while other non-negotiable paper remains under the confused common law. In view of its purpose to make uniform the law concerning *all* commercial paper, it seems essential that the Code include some further provision with regard to instruments non-negotiable for reasons other than lack of words of negotiability.[98] It is impossible to lay down a standard which will once and for all determine what other instruments should come within the Code. But that does not preclude a legislative mandate to the courts that certain instruments which meet a general test be included. In formulating such a test, it will be helpful to remember that in every case where the courts have imposed indorser liability, the instrument was similar in form to a negotiable instrument,[99] and that in no case has such liability been imposed where the obligation has not been to pay money.[100] It might be provided that if an obligation to pay money is embodied in an instrument whose form indicates that the parties dealing therewith intended it to be freely transferable, and if such intention is reflected in current business practice, it shall come within the Code even though non-negotiable, except that there can be no holder in due course.

92. CODE § 805.
93. Patterson v. Poindexter, 6 W. & S. 227 (Pa. 1843).
94. Goodrich, *Nonnegotiable Bills and Notes,* 5 IOWA L. BULL. 65, 71 (1920).
95. For discussion of the policy of promoting circulation of negotiable paper see Chafee, *Acceleration Provisions in Time Paper,* 32 HARV. L. REV. 747, 750 (1919).
96. See note 3 *supra.*
97. Persky v. Bank of America Nat. Ass'n, 261 N. Y. 212, 185 N. E. 77 (1933).
98. For discussion of the general aims of the Code, see Gilmore, *On the Difficulties of Codifying Commercial Law,* 57 YALE L. J. 1341 (1948).
99. See notes 84-86 *supra.*
100. Gray v. Donahoe, 4 Watts 400 (Pa. 1835) (payable in current bank notes).

Concededly, this leaves much to the courts, but it is not inconsistent with the old and salutary practice of having the courts look to business practice to determine the law applicable to commercial paper.[101]

Conclusion

The Code takes a forward step toward clarification of the law of non-negotiable paper by including within its purview instruments whose only defect is the omission of words of negotiability. In applying to such non-negotiable paper and to negotiable paper the same rule of indorser liability, the Code recognizes a policy of the common law, but is not strictly a codification of common law rules. As to the warranties of a transferor of non-negotiable paper, the Code comes much closer to a codification of the common law, except that warranties are made to run to subsequent holders. So far as it goes, the Code provision is desirable, but it should be extended to cover many commercial instruments non-negotiable for reasons other than lack of words of negotiability. Such application of the same rules to negotiable and non-negotiable instruments does not erase the principal distinction between them, since there can be no holder in due course of a non-negotiable instrument even under the Code.[102]

E. L. N.

Standard Jury Instructions

In recent years a considerable number of judges and lawyers have criticized the traditional system of jury instruction.[1] The standard instruction has been lauded as a modern device for eliminating many of the defects of the older practice.[2] This Note will describe its operation and will evaluate its adequacy for the lay jury's needs.

Under the traditional system of instruction, the judge has to present the factual issues to the jury in his own words.[3] As a consequence, less skilled judges have subjected the jury to a tangled complexity of verbiage,

101. *See* Cudahy Packing Co. v. State Nat. Bank, 134 Fed. 538, 542-43 (8th Cir. 1904).

102. In general, see Lewis, *The Proposed New Commercial Code*, 20 Pa. B. A. Q. 131 (1949); Beers, *New Steps Toward Uniformity—The Commercial Code*, 20 Conn. B. J. 80 (1946).

1. Among the suggestions for improving jury instructions, in addition to the standard instruction, have been the following: (a) Use of jury manuals—Bishop, *Let Us Really Inform Our Jurors*, 20 Cal. State Bar J. 99 (1945); (b) Revision of education of legal profession—Trusty, *The Value of Clear Instructions*, 15 Kan. City L. Rev. 9 (1947); (c) More specific framing of instructions—McCleary, *Defense of Sole Cause in the Mo. Negligence Cases*, 10 Mo. L. Rev. 1, 27-28 (1945); (d) Modified special verdicts—Green, Judge & Jury 355 (1930); (e) Enlarging the power of judge to comment on the evidence—A. B. A. Rep., Committee on Judicial Administration 53 (1946).

2. Caplan, *Standardized Jury Instructions in Illinois*, 7 John Marshall L. Q. 313 (1942); Price, *Standardized Jury Instructions for Illinois*, 23 Chic. Bar Rec. 228 (1942).

3. James, *Function of Judge and Jury in Negligence Cases*, 58 Yale L. J. 667 (1949); Rossman, *The Judge-Jury Relationship in the State Courts*, 10 Law Soc'y J. 349, 354 (1942). See also Proffatt, Trial by Jury §§ 311-350 (1877).

much of which is neither usable nor understandable by laymen.[4] Again, the discretion given to the trial judge in formulating proper instructions has led to inadvertent error because of careless inclusion of a wrong word,[5] or as the result of unconscious bias operating on the judge's choice of words.[6] Even in the absence of actual reversible error, it is difficult to avoid prejudicing the jury slightly. Finally, counsel have often abused the privilege of requesting instructions by choosing language designed to befuddle the jury or deliberately to produce error.[7]

The standard instruction has attempted to remedy these defects by limiting instructions to statements of legal principles.[8] Standard instructions cannot be couched in terms of the evidence, which varies necessarily from case to case. Further, anything less than an exclusive use of standard instructions would leave untouched the problems within the area of non-standard instructions. The jury, therefore, is left to apply the rules of law to the evidence with only the help of arguments of counsel.[9]

California's Book of Standard Instruction, of which two volumes have appeared so far, is typical. One volume deals with criminal prosecutions,[10] and the other primarily with the common types of negligence actions.[11] The text is a careful product of experts, and sets forth legal principles, organized especially for use at trial, in simple language designed for laymen's understanding. Similarly, provision is made for the use of the same standard instructions by counsel in their requests for charge.[12] Obviously the adoption of uniform language from case to case will tend to eliminate some of the defects in the present system.[13] In addition, time

4. *E. g.*, Cummings v. Penna. Ry., 45 F. 2d 152 (2d Cir. 1930); Southern Bldg. & Loan Ass'n v. Holmes, 227 Ala. 1, 149 So. 861 (1933); Johnson v. State, 99 Tex. Crim. 25, 267 S. W. 713 (1925). See also A. B. A. REP., COMMITTEE ON JUDICIAL ADMINISTRATION 52 (1946); GREEN, *op. cit. supra* note 1, at 351. But compare *The Jury Looks at Trial by Jury*, 31 J. AM. JUD. SOC'Y 105, 107 (1947) (poll of jurors indicating satisfaction with traditional instructions). Judges sometimes use such equivocal terms intentionally in order to avoid the hazard of taking a position which might lead to reversal. *E. g.*, Citizens Trust & Guaranty Co. v. Ohio Valley Tie Co., 138 Ky. 421, 128 S. W. 317 (1910); GREEN, *op. cit. supra* note 1, at 316.

5. *E. g.*, Klaus v. Sheets, 333 Ill. App. 151, 79 N. E. 2d 86 (1948) (use of "could" instead of "would" in defining contributory negligence); Palmer, *Standardized Jury Instructions Succeed*, 23 J. AM. JUD. SOC'Y 177, 180 (1940). Reversal may be avoided by application of the doctrine of prejudicial error. *See* Syms v. Horman, 134 Conn. 653, 657, 60 A. 2d 166, 167 (1948); De Stanis v. Lange, 137 N. J. L. 480, 483, 66 A. 2d 630, 633 (1948); Farley, *Instructions to Juries—Their Role in the Judical Process*, 42 YALE L. J. 194, 210-214, 224 (1932) (discussion of means of avoiding reversal, pointing out the tendency of appellate courts to encroach unduly upon the functions of the trial court).

6. *E. g.*, Sacramento Suburban Fruit Lands Co. v. Jenson, 36 F. 2d 936 (9th Cir. 1929); Gaskins v. Kelly, 228 N. C. 697, 704, 47 S. E. 2d 34, 38 (1948).

7. It has been contended that requests for instructions may be worded trickily so as to make their refusal a ground for procurement of a new trial in the event of an adverse verdict. Farley, *supra* note 5, at 214-216.

8. CALIFORNIA JURY INSTRUCTIONS CIVIL (hereinafter cited as BAJI) xxix (1943).

9. BAJI xxix; CALIFORNIA JURY INSTRUCTIONS CRIMINAL (hereinafter cited as CALJIC) xxxvi (1946).

10. CALJIC.

11. BAJI. Other jurisdictions using some form of standard instruction include the following: Nebraska—Nos. 1-56 appearing in Bar Ass'n Section, 24 NEB. L. REV. 196 (1945), and Nos. 57-74 in Bar Ass'n Section, 25 NEB. L. REV. 638 (1946); Florida—in 20 FLA. B. A. J. 60 (1946); Municipal Court of Chicago—published as a form book in a limited edition not available for general use.

12. Counsel obtain the applicable instructions on printed forms from the clerk of court, and submit them in appropriate combination to the trial judge. Slight deviations to meet differences in fact are, however, countenanced. BAJI xxxii.

13. Forewords, CALJIC and BAJI; and generally Caplan, *supra* note 2; Price, *supra* note 2; Palmer, *supra* note 5.

and effort will be saved for the trial lawyer as well as the judge. The value of a treatise of legal principles designed for use in the trial court is indisputable.[14] Nevertheless, the standard instruction introduces new problems which require closer examination.

NONCONCRETENESS: A SERIOUS WEAKNESS

The jury instruction is the basic means by which the court informs the jury of its duties. Since the jury is the fact finding body, the court must explain to it the factual issues and the legal consquences flowing from the resolution of these issues. Under the traditional system, the court accomplishes this by summarizing the evidence on each side of the issue, and by explaining the bearing of each finding of fact on the disposition of the case.[15]

The standard instruction assumes that the jury needs neither explanation of the factual issues nor summary of the evidence. A detailed statement of the relevant legal principles is deemed sufficient to enable the jury to find its own way. This hypothesis is extremely doubtful. Rules of law are, of course, sufficient for many jury purposes. It is proper, for example, to tell the jury that they are the trier of facts and that the judge decides the law; [16] or that they must consider the evidence without regard to sympathy, prejudice, or passion for or against either party.[17] Similarly, they may be told in the form of a legal principle how they must treat a cross claim,[18] or a case involving joint liability.[19] Many situations, however, cannot be explained to a jury in terms of principles of law, no matter how detailed the latter are made. Four illustrations are offered here:

I. Two cars are travelling in opposite directions toward an intersection. *A* attempts a left hand turn and is struck by *B* just before completing the turn. An action brought by *A* for negligence is opposed by a counterclaim from *B* who similarly alleges negligence. Evidence is introduced that *A*, in making the turn, failed to give the proper hand signal. One of the issues facing the jury is, therefore, whether or not such failure was a proximate cause of the accident.[20]

The relevant California standard instructions defining proximate causation are as follows:

> "The proximate cause of an injury is the cause which in natural and continuous sequence unbroken by any efficient and intervening cause produces the injury and without which the result would not have occurred. It is the efficient cause—the one which necessarily sets in operation the factor which accomplishes the injury.[21]

14. Model books of instructions are not new. ASTRY, A GENERAL CHARGE TO ALL GRAND JURIES AND OTHER JURIES (1725) appears to be one of the earliest. RANDALL, INSTRUCTIONS TO JURIES (1922) is typical of what is presently available for use. It has also been a common practice for judges to record in private form books the general instructions which they use recurrently.

15. PROFATT, *op. cit. supra* note 3, § 311; McCleary, *supra* note 1, at 27-28.

16. *E. g.*, BAJI 1; Florida Standard Instructions No. 1.

17. *E. g.*, BAJI 4; CALJIC 1.

18. *E. g.*, BAJI 51.

19. *E. g.*, BAJI 54.

20. This illustration is taken directly from the illustrations in BAJI xxxvii, designed to explain the use of the standard instruction.

21. BAJI 104; *cf.* Nebraska Standard Instructions Nos. 50 and 60.

> "This does not mean that the law meets and recognizes only one proximate cause of an injury consisting of only one factor, one act, one element of circumstances for the conduct of only one person. To the contrary, the acts or omissions of two or more persons may work concurrently as efficient cause of an injury and in such a case each of the participating acts or omissions is regarded in law as a proximate cause." [22]

Can such an instruction really aid the jury to determine, from the conflicting viewpoints of the accident, whether or not to consider the failure to give the hand signal as the proximate cause of the injury? Lawyers have argued for generations over the meaning of "natural and continuous sequence" and "efficient cause." [23] Present methods of instruction might not be completely adequate, but they would segregate more sharply what the jury must determine and what the judge himself will decide. The phrasing of the rule of proximate cause in terms of the evidence would make more sense to the jury. They might be told, for example, that they must find that there was a failure to give a hand signal, and that the accident would not have occurred if such signal were given. They would then be charged that even if they found that *B* was also careless, *A* would not be relieved of responsibility for failure to give the signal, unless the accident would have occurred in any event.

II. A printer is tried for criminal conspiracy, with evidence tending to show that he had printed tickets for a group engaged in conducting a "baseball pool." [24] The California Criminal Charges which appear to be relevant are as follows:

> "The law defines conspiracy to be an agreement or understanding between two or more persons that they will commit an unlawful act, that is, that they will combine together to accomplish by united action a criminal or unlawful purpose, or a purpose, which is not in itself criminal or unlawful, by criminal or unlawful means, to accomplish which agreement in furtherance thereof an overt act is committed by one or more of the parties to the agreement. In other words, conspiracy is a criminal partnership, the object of which is to do an unlawful act or a series of unlawful acts, or to do a lawful act or a series of lawful acts by unlawful means, accompanied by an overt act to effect the object of such agreement." [25]
>
> "It is not necessary in proving a conspiracy to show a meeting of the alleged conspirators or the making of an express or formal agreement. The formation and existence of a conspiracy may be inferred from all the circumstances tending to show the common intent and may be proved in the same way as any other fact may be proved, either by direct testimony of the fact or by circumstantial evidence, or by both direct and circumstantial evidence." [26]

Does such a instruction properly distinguish between the function of court and jury? It leaves it to the jury to say what constitutes an "un-

22. BAJI 104A.

23. PROSSER, TORTS 311-320 (1941) (containing discussion of and proposed solution for the substantive problem).

24. *Cf.* Commonwealth v. Mittleman, 154 Pa. Super. 572, 36 A. 2d 860 (1944).

25. CALJIC 931.

26. CALJIC 934 (offering also alternate instruction).

lawful purpose" and "unlawful means" as well as what is an "overt act." [27] Of course the statutory definition of a lottery might have been added. Further, the jury is not told what circumstances tend to show "the common intent" to conspire. They would have been better informed, even without being told as fully what a conspiracy is, if the charge stated that the sale of these tickets constituted an unlawful lottery, and that in order to find the defendant guilty they would have to find him a party to an agreement the design of which was to distribute these tickets against the law. Finally they might be told that they should consider his knowledge of what the tickets were used for, and his act in printing them, as circumstantial evidence going to the issue of whether he had been a party to such an agreement.

III. *A* is indicted for conspiracy to assault union employees of his employer in a case where the fact of the assault had been proven.[28] In addition to the instructions in the preceding illustration, the jury might be asked to consider the following:

> "The formation and existence of a criminal conspiracy belong to a class of facts which seldom can be established by direct evidence. In the very nature of the case such common design rarely can be shown by direct evidence, and often can be shown only by circumstantial evidence. A finding of the formation and the existence of a conspiracy may stand on circumstantial evidence alone, if from all the evidence the jury is convinced beyond a reasonable doubt of the existence of such facts. In determining the question whether or not an alleged conspiracy was formed and existed, it is proper to take into consideration the relation of the accused parties to one another, if the evidence shows any connection between them, their personal and business associations with each other, if any, and any and all facts in evidence which may tend to show what, if anything, occurred between them, at or before the time of the alleged combination or agreement, or which tend to show what, if anything, occured between them, or any of them, thereafter in relation thereto, as well as evidence of any acts performed and declarations made by any of said parties subsequent to the formation of such alleged combination or agreement in respect to, and in pursuance and furtherance of, the alleged conspiracy. From such facts and circumstances as shown by the evidence you will determine whether or not a criminal combination or agreement did in fact exist as charged in the case, and if it did exist, which, if any, of the defendants were parties to such conspiracy." [29]

Much of this instruction would be of little help to a jury. Phrases like "relation of the accused parties to one another" have little meaning

27. CALJIC 938 defines *overt act* as "any step or act by anyone of the conspiracy which goes beyond mere planning, agreement and intent toward the accomplishment of the object of the conspiracy, and which is done to effect that object.

"Such an act need not, in and of itself, constitute the crime or even an immediate attempt to consummate the crime . . . nor need it be, in and of itself, a criminal or an unlawful act."

This language is so broad that it appears to offer little positive help to the jury. The substantive problem is nonexistent in Pennsylvania where no overt act is necessary to constitute a conspiracy beyond that of the agreement itself. Commonwealth v. Richardson, 229 Pa. 609, 79 Atl. 222 (1911).

28. *Cf.* People v. Borrelli, 392 Ill. 481, 64 N. E. 2d 719 (1946).

29. CALJIC 933.

apart from evidence to which they might be referred. The jury would be better informed if they were told, for example, that they were to consider the extent to which the defendant was taken into his employer's confidence in connection with labor relations, as well as any evidence of special friendship or trust between the two, as factors tending to indicate that such an agreement existed. Further, the use of the more general instructions defining conspiracy would be purposeless in this case, since the existence of an agreement is the only issue for the jury. Their use might be encouraged by their ready availability, and could easily divert the jury's attention from what it must decide.

IV. A Nebraska standard instruction states the rule concerning the effect of frolic as opposed to detour, on the master's liability, where there is undisputed evidence that a servant who had been directed to drive a car to his master's garage has negligently injured someone.[30] In substance, it provides that the servant must have been within the scope of his employment at the time of the injury, and that the employer will not be relieved of liability if the servant's negligence occurred while making a "slight deviation" from the direct route of destination, but will be relieved if the negligence occurred while there was such a "substantial deviation or departure as to amount for the time being to an abandonment of the employer's business."

The instruction is probably a fair statement of the rule of law. Yet suppose the driver went three blocks out of his way to buy a paper out of a total trip of six blocks?[31] Suppose he went three blocks to his home to bed for the night, thinking that he would return the car in the morning?[32] How can the jury determine whether the deviation is "slight" or "substantial"? A general statement emphasizing the importance of considering the relation of distance and time of the entire trip to that of the deviation or departure would help. Nevertheless, the jury would be in a more intelligent position if the relationship were graphically demonstrated in terms of the precise evidence they must consider, rather than in terms of an abstract rule.

The Pennsylvania point of view is displayed in a recent case.[33] There the defendant, blinded by the lights of an approaching car, drove off the road on to a shoulder, and overturned while trying to regain the road and to reduce speed simultaneously. Action was brought against him for the death of a guest passenger. In the trial court, the jury was charged to consider "the handling of the car," to determine whether or not the defendant was negligent. This instruction was held reversible error, on the ground that it was so general as to be misleading, even though abstractly correct. The court pointed out that the jury should have been told specifically that the defendant might have been negligent after leaving the road, *e. g.*, by failing to slow down promply, even if blameless prior to that time.[34]

The jury cannot decide difficult factual issues without the assistance of professionals in formulating these issues.[35] Proponents of standard

30. Nebraska Standard Instruction No. 12; *cf.* BAJI 54D.

31. *Cf.* Loomis v. Hollister, 75 Conn. 718, 55 Atl. 561 (1903); Riley v. Standard Oil Co., 231 N. Y. 301, 132 N. E. 97 (1921).

32. *Cf.* Wilson & Co. v. Shaw, 157 Okla. 34, 10 P. 2d 448 (1932).

33. Randolph v. Campbell, 360 Pa. 453, 62 A. 2d 60 (1948); *cf.* Western Ky. Coal Co. v. Davis, 138 Ky. 667, 128 S. W. 1074 (1910).

34. Randolph v. Campbell, *supra* note 33, at 456, 62 A. 2d at 62.

35. Trusty, *supra* note 1, at 11, advocates further education for the legal profession particularly along these lines.

instructions contend that this objection is adequately met by counsel's arguments to the jury.[36] The evidence, they say, will be fitted into the legal principles composing the instructions by both sides, and the jury can choose intelligently between the two sides. Their position is stengthened by the fact that, with standard instructions, lawyers know to a large extent what the charge will contain and can prepare their arguments accordingly.

There is likely to be disagreement, however as to the nature of the factual issues to which the legal principles are to be applied. Counsel will generally attempt to present the evidence in terms of their own theory of the case so as to minimize the relevancy of the evidence which favors the opposing side. The jury will be forced to depend for guidance upon two totally dissimilar theories of opposing interested parties. If, for example, a pedestrian is struck from behind while crossing a street, the jury's function in sifting the evidence would not be to determine whether or not he is to be charged with the absolute duty of looking behind him.[37] The same motivations exist which have led to abuses in the traditional method where lawyers request instructions.[38] These evils would be magnified through the loss of the judicial power to exclude.[39]

Finally, the standard instructions add an element of sterility to the law. It is common knowledge that, under the stimulus of changing conditions, important legal principles have evolved at the trial court level. Both judges, and counsel as well, have contributed to the progress.[40] Existing rules, applied to new situations, have been given novel twists which, in time, are recognized as modifications of the general rules. At some point, as the process continues, old theories are discarded and new ones accepted. The habit of standard instructions may have a tendency to stunt this growth by encouraging the use of pigeon-holes. It will require able judges and lawyers to discriminate between situations for which the instructions were designed and the novel situation which demands individualized treatment. Under the traditional system, there is less pressure to conform instructions to well worn grooves.

Conclusion

The standard jury instruction is too untried for a determination of its value from actual experience.[41] Examination of the contents of the instructions indicates, however, that jurors will not be so well informed of what they must decide as under the traditional system. The evils of jury instruction need more basic remedies. In large part, they may be due to insufficiently trained personnel.[42] While it is true that standard instructions will prevent faulty wording of legal principles, they cannot

36. BAJI xxix; CALJIC xl.

37. *Cf.* Johnson v. Griepenstroh, 150 Neb. 126, 132, 33 N. W. 2d 549, 553 (1948). BAJI 201C appears too general to guide a jury through this pitfall.

38. See note 7 *supra.*

39. *E. g., In re* Schofield, 362 Pa. 201, 216-217, 66 A. 2d 675, 677-679 (1949).

40. Rothschild, *Men and Law,* 1 BROOKLYN L. REV. 1 (1932).

41. Both Reed v. Stroh, 54 Cal. App. 2d 183, 188, 128 P. 2d 829, 832 (2d Dist. 1942), and Temple v. DeMirjian, 51 Cal. App. 2d 559, 566, 125 P. 2d 544, 548 (2d Dist. 1942), indicate early enthusiasm on the part of the appellate court judiciary for the new system. More recently, Judge Bishop, one of the judges of the court which first adopted standard instructions, has published the article cited *supra* note 1, indicating that some judges are no longer satisfied with it.

42. Stone, *Instructions to Juries: A Survey of the General Field,* 26 WASH. U. L. Q. 455 (1941).

relieve the judge from the ultimate responsibility of deciding which principles are applicable.[43] Yet it appears that this is one of the greatest single causes of reversible error in the charge.[44] The rules of law themselves are sometimes so unrealistic that little can be said for them except that they provide a façade behind which the jury dispenses rough justice while the legal framework itself retains the appearance of logical certainty.[45] Finally, rules of law occasionally so conflict with the mores of the times, that the jury deliberately refuses to follow them.[46] Toward these rules and the men who state them in the instructions efforts for reform must primarily be directed.

L. L.

Criminal Sanctions Protecting the Credit Seller

The United States has so far emerged into a credit economy that some writers have said that money is now merely a substitute for credit.[1] Credit arises when the ownership of wealth is divorced from the necessity for its use. Fundamentally, it comes into being when a person obtains the use of money or goods in exchange for a promise to make payment in the future. It consists of both tangible and intangible elements. The former is represented by the property of the seeker of credit, fortified by confidence that he will preserve that property either in its original or equivalent form to serve as a practical basis of his ability to redeem the obligation incurred. The intangible element is the buyer's good faith and the feeling of certainty that he will have the ability to make the assertion of his power over future events come true.[2] Basically, the transfer of goods and services for a mere promise to pay is nothing more than the confidence we have in expected behavior of citizens, legislators and judges.[3] The importance of jealously protecting this confidence cannot be overemphasized. Toward this end, the criminal law has long been used to supplement civil relief to preserve and protect private property. However, as business transactions have become more complex, particularly in the credit field, the concept of split ownership of property has made the problem of protecting divided, and often conflicting, property interests a troublesome one. The difficulty lies not only in determining which party has the protected right but also in preserving the dichotomy between honest misfortune and fraudulent misconduct in commercial transactions.[4] It is the purpose of this Note to explore the steps the several states have taken by utilizing criminal sanctions to protect the seller of goods on credit.[5] Considerable attention has been paid to the Pennsylvania law.

43. BAJI xxx; CALJIC xli.

44. A limited survey of recent cases made by the writer indicates that a substantial number of reversible errors were the result of faulty application of law to the facts. Standard instructions would not remove this source of error.

45. FRANK, LAW AND THE MODERN MIND c. XVI (1930).

46. Stone, *supra* note 42, at 455-458.

1. PRENDERGAST AND STEINER, CREDIT AND ITS USES 3 (1931).

2. WILLIS AND EDWARDS, BANKING AND BUSINESS 511 (rev. ed. 1925).

3. See COMMONS, LEGAL FOUNDATIONS OF CAPITALISM 245 (1924).

4. HALL, THEFT, LAW AND SOCIETY 33 (1935).

5. The scope of this Note is limited to state legislation and excludes crimes under federal statutes, including the Bankruptcy Acts. However, see note 80 *infra* and text for mention of the fraudulent bankruptcy problem.

Historical Development

As the commercial revolution took place, the criminal law became conscious of its obligation to keep abreast of large-scale changes in the economic structure. This was due to a shifting of emphasis from an agricultural economy to an industrial structure which incorporated into its framework largely movables.[6] The basic penal sanction used to protect the ownership of property was larceny. But as the structure became more complex, the traditional concepts, steeped with the requirements of "caption" and "asportation," became less adequate. Common law larceny protected only the possessor of goods from a wrongful trespass. It was not until 1780 in *Pear's Case*,[7] that the larceny concept was extended to those cases in which *possession* was obtained by fraud. But where *title* to the goods passed, even if obtained by fraud, the common law was of little avail. Similarly, the crime of getting property by false token was extremely limited. The means used had to be such as to affect the public at large and not merely a single individual.[8] The offense was gradually broadened by statute, until, in 1757, obtaining property by false pretenses was outlawed.[9]

The increasing inequality in the distribution of property led to a corresponding need to leave property in the hands of servants and other persons. The common law had enlarged the concept of possession in 1529 so that if a servant converted property received directly from his master he was guilty of larceny. But the servant or agent committed no offense if he received money for his master's account from a third person and converted it to his own use.[10] To correct this anomaly, the statutory crime of embezzlement was conceived in 1799.[11] Meanwhile, the bailee enjoyed a peculiar position of freedom. Although *Carrier's Case* had been decided in 1473,[12] the decision was limited to the situation where the bailee "broke bulk." It was not until 1857 that a statute creating the crime of larceny by bailee was enacted.[13]

Statutory ramifications have broadened these traditional concepts in certain fields. For example, the element of agency relationship in the embezzlement statutes has been extended to include that of trustee, banker, public official and many others.[14] The so-called fraudulent conversion statute made it a crime for one to convert the goods of another held in any capacity or the proceeds derived from the sale thereof.[15] These were the tools long accepted in this country for the protection of property. As the expansion of mercantile and banking credit continued, however, it became necessary to safeguard the merchant who extended credit. Before surveying the criminal sanctions which have been adopted for the protection of the credit seller, it may be helpful to look at the limitations,

6. Mannheim, Criminal Justice and Social Reconstruction 86 (1946).
7. 1 Leach 211, 168 Eng. Rep. 208 (K. B. 1780). See Hall, *op. cit. supra* note 4, at 11.
8. Kenny, Outlines of Criminal Law 227 (Am. ed. 1907); Hall, *op. cit. supra* note 4, at 11, 16.
9. 30 Geo. II, c. 24 (1757).
10. King v. Bazeley, 2 Leach 973, 168 Eng. Rep. 517 (K. B. 1799).
11. 39 Geo. III, c. 85 (1799). This was the first general embezzlement statute, although it had been made criminal to embezzle from specific principals, *e. g.*, The Bank of England, The South Sea Co., etc. See Hall, *op. cit. supra* note 4, at 9.
12. Y. B. Pasch. 13 Edw. IV, f. 9, pl. 5 (1473). Hall, *op. cit supra* note 4, at 315.
13. 20 & 21 Vict., c. 54 (1857), *superseded by* 24 & 25 Vict., c. 96, § 3 (1861).
14. *E. g.*, Ill. Ann. Stat., tit. 38, §§ 216, 209, 214, 208 (Smith-Hurd, 1935).
15. *E. g.*, Pa. Stat. Ann., tit. 18, § 4834 (Purdon, 1945).

articulate and inarticulate, which govern the extent to which they may be utilized.

LIMITATIONS ON CRIMINAL SANCTIONS

Imprisonment for Debt.—The most serious and far-reaching limitation on imposing criminal sanctions to protect creditors is a fear of reverting to the use of imprisonment for debt. Until 1830 the practice was widely used in both England and the United States.[16] In the Middle Atlantic states during that period, three to five times as many persons were imprisoned for debt as for crime, and most of the sums involved were very small. Starting in 1830, a wave of reform swept the country, in the form of state statutes or constitutional amendments abolishing imprisonment for debt except in enumerated situations. Today thirty-nine states have such a constitutional provision, the usual type forbidding the practice except in cases of fraud.[17] With this exception, the limitation is considerably less formidable, since so long as the element of fraud exists there is no prohibition against making such conduct a criminal offense.[18] The constitutional provisions were intended to prevent resort to imprisonment for the collection of contract debts, and not to prevent the state from imposing a criminal sanction where the public interest justifies declaring certain conduct to be a crime.[19] Clearly then, it is proper to denounce fraud in the inception of a contract or debt, since fraud is a distinct injury to the state. In this vein, enactments have been upheld which make it criminal to obtain accommodation at an inn with intent to defraud,[20] and to receive deposits in a bank knowing of its insolvency.[21] As yet, however, no law has been passed, or statute construed, to make it criminal for a merchant to continue to accept credit when he is factually insolvent.[22]

The bad check laws [23] have been attacked as contrary to the constitutional prohibition. They have been upheld generally even where they do not require that property actually be obtained by the use of the worthless instrument.[24] One enactment which made the giving of a post-dated check without sufficient funds a criminal offense, has been held unconstitutional as imprisonment for debt.[25] A Georgia court has declared that, unless the intent to defraud was an indispensable element, the statute would be invalid as an instrument for the collection of debt by process of the criminal law, in contravention of sound public policy and of the constitutional provision.[26]

On the other hand, some statutes have flown in the face of the prohibition with continued success. Illustrative of these are the enactments which deal with employers who obtain personal services by a false promise of

16. See Ford, *Imprisonment for Debt,* 25 MICH. L. REV. 24 (1926); Comment, 37 YALE L. J. 509 (1928).

17. The several states' constitutional provisions are listed in Note, 41 HARV. L. REV. 786 (1928).

18. *E. g.,* Freeman v. United States, 217 U. S. 539 (1910).

19. Comment, 37 YALE L. J. 509, 513 (1928).

20. See text at note 50 *infra.*

21. *E. g.,* State v. Willis, 130 Tenn. 403, 170 S. W. 1030 (1914). For a complete discussion see Comment, 43 YALE L. J. 1304 (1934).

22. MICHAEL AND WECHSLER, CRIMINAL LAW AND ITS ADMINISTRATION 474 (1940).

23. See text at note 53 *infra.*

24. Hollis v. State, 153 Ga. 182, 108 S. E. 783 (1921); State v. Avery, 111 Kan. 588, 207 Pac. 838 (1922); State v. Pilling, 53 Wash. 464, 102 Pac. 230 (1909).

25. State v. Nelson, 58 S. D. 562, 237 N. W. 766 (1931).

26. Neidlinger v. State, 17 Ga. App. 811, 88 S. E. 687 (1916).

compensation.[27] Most statutes do include as an element the intent to defraud, to circumvent the prohibition in the typical state constitution. Such statutes have been held invalid where they purported to punish fraud irrebuttably presumed from the breach of the contract.[28] But where the essence of the statutory offense is fraud, the right to punish the employer seems clear.[29] A recent California decision upheld an enactment which makes it criminal for any employer, having the ability to pay, wilfully to refuse to pay wages when due.[30] The statute did not require fraudulent intent; nevertheless, the court found fraud from circumstances surrounding the non-payment rather than in the transaction from which the obligation grew.

As to mechanics liens, some states have put teeth in their civil provisions by declaring that the contractor's use of funds paid to him by the owner under a contract to build or make other improvements on realty, for any purpose other than the payment of laborers or materialmen, constitutes embezzlement.[31] In New York, such action by the contractor or a sub-contractor constitutes larceny.[32]

Freedom of Trade.—Running alongside this limitation is an undefined reluctance of the courts to impose criminal sanctions in the realm of commercial transactions. Fundamentally, there is the fear that the threat of criminal prosection might be employed to exert pressure in an ordinary contract dispute.[33] Perhaps more justified is the desire not to impede commercial progress and to preserve the verve of the market place.[34] The same disposition not to cramp the style of trade, buttressed by the historical concepts of *laissez-faire* and *caveat emptor,* inhibited the evolution of the law of fraud.[35] In the eighteenth century, when *A* got money from *B* by pretending to be sent as *C's* agent, Lord Holt grimly said, "Shall we indict one man for making a fool of another?" and bade the prosecutor have recourse to civil action.[36] While today the courts are more willing to draw the line between an arm's length business transaction and commercial fraud, the shackles of tradition remain a restricting factor on the use of the criminal sanction in this field.

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27. *E. g.,* Md. Laws 1939, c. 384.
28. Bailey v. Alabama, 219 U. S. 219 (1911).
29. *E. g.,* Lamar v. State, 120 Ga. 312, 47 S. E. 958 (1904).
30. *Ex parte* Trombley, 31 Cal. 2d 801, 193 P. 2d 734 (1948), 97 U. OF PA. L. REV. 281 (1948).
31. See Note, 41 HARV. L. REV. 786, 787 (1928). The authorities are at variance as to the constitutionality of such enactments. State v. Harris, 134 Minn. 35, 158 N. W. 829 (1916) (sustained); People v. Holder, 53 Cal. App. 45, 199 Pac. 832 (2d Dist. 1921) (invalid); *cf.* IND. STAT. ANN., § 10-2112 (Burns, 1942).
32. N. Y. LIEN LAW §§ 36-a, 36-b.
33. *E. g.,* Chaplin v. United States, 157 F. 2d 697 (D. C. Cir. 1946); Commonwealth v. Weiner, 340 Pa. 369, 17 A. 2d 357 (1941); Commonwealth v. Mitchneck, 130 Pa. Super. 433, 198 Atl. 463 (1938); Commonwealth v. Bixler, 79 Pa. Super. 295 (1922). See 34 HARV. L. REV. 557 (1921).
34. See Orfield, *Criminal Misrepresentation: Obtaining by False Pretenses,* 14 NEB. L. BULL. 129, 139 (1935); Comment, 21 TULANE L. REV. 639, 642 (1947).
35. HAMILTON, ANCIENT MAXIM CAVEAT EMPTOR, 40 YALE L. J. 1133, 1184 (1931); HALL, *op. cit. supra* note 4, at 33; MANNHEIM, *op. cit. supra* note 6, at 120.
36. See MANNHEIM, *op. cit. supra* note 6, at 121. Compare Lord Mansfield's famous dictum that a person who is fooled by his own credulity should be "left to civil action." Rex v. Wheatley, 2 Burr. 1125, 1127, 97 Eng. Rep. 746, 748 (K. B. 1761). Such statements led a contemporary, Jonathan Swift, to remind his countrymen, "they (the Lilliputians) look upon fraud as a greater crime than theft, and therefore seldom fail to punish it with death; for they allege that care . . . may preserve a man's goods from theft, but honesty has no defense against superior cunning." GULLIVER'S TRAVELS, c. VI.

Popular Sentiment.—Another limitation is the unwillingness on the part of the credit seller himself to take steps to utilize the existing penal law. Not only does he realize that he may lose good will but he stands to gain little from having a delinquent languish in prison. This natural reluctance is given impetus by the striking success of malicious prosecution suits in which court and jury have thought that prosecution was instituted merely to collect a debt and not for the benefit of society.[37] Of paramount importance is the effect of public sympathy. In the public eye, creditors are grasping; finance companies are cruel and wicked; bankers stand little higher, despite their dignity. If public sentiment favors the debtor class, it will have its effect on legislatures and courts, as well as juries. While such reflection of public opinion may be desirable, it may also create a tendency to lose sight of the fundamental distinction between the honest debtor and the dishonest swindler. Perhaps even more important is the effect public opinion will have, not in inhibiting enforcement of the law, but in stultifying its object. If the convicted man gains widespread public sympathy, sanctions will have little deterring effect.

Inducing Credit by False Pretenses

The first protection afforded the seller under existing penal law is at the pre-sale stage, where the buyer induces the seller to extend credit by a false pretense. In an impersonal economy, credit will only be extended after analysis of the worth of those who seek it. Both the tangible and intangible elements of credit must be carefully scrutinized in order that the seller or his financer may be able to evaluate the buyer as a credit risk. Several types of fraud are common in this connection.

False Financial Statements.—The financial statement offers the dishonest business man opportunity to misrepresent the tangible element of credit. This is because of the great reliance placed upon the capital factor by many credit men, and because of the difficulty of detecting falsity in a financial statement.[38] Yet the crime of false pretenses includes within its penumbra only situations where the falsifier obtains property from the deceived.[39] The majority of the commercial states, at the instance of the National Association of Credit Men, have adopted special statutes which make it criminal to make a statement, either personally or through a credit agency, which is materially false, for the purpose of securing credit and with an intent that it be relied on.[40] Thus, under a fair construction of the statutes, blocks are imposed at the pre-loss stage, and the vaporous "intent to defraud" is no longer required; nor is it necessary that any benefit be received.[41] A few states have reached the same result by use of their false pretense statutes.[42]

37. *E. g.*, Cooper v. Schirrmeister, 176 Misc. 474, 26 N. Y. S. 2d 668 (N. Y. City Ct. 1941); Winans v. Congress Hotel Co., 227 Ill. App. 276 (1st Dist. 1922); *cf.* Payne v. East Liberty Spear Co., 323 Pa. 100, 185 Atl. 853 (1936). *But cf.* Andrews v. Hotel Sherman, 138 F. 2d 524 (7th Cir. 1943).

38. Chapin, Credit and Collection Principles and Practice 253 (1929).

39. Fixel, False Financial Statements 156 (1924).

40. The New York statute is typical, N. Y. Penal Law § 1293-b. See Credit Manual of Commercial Laws 353 (Nat. Ass'n of Credit Men, 1948); *cf.* People v. Berkenfield, 191 Ill. 272, 61 N. E. 96 (1901) (no property need actually be obtained). In California the penalty is greater if property or credit is actually obtained. People v. Breyer, 139 Cal. App. 547, 34 P. 2d 1065 (2d Dist. 1934).

41. Michael and Wechsler, *op. cit. supra* note 22, at 473.

42. State v. Ball, 114 Miss. 505, 75 So. 373 (1917). In general, prior to these statutes it was not an offense for one to make a written representation as to another's financial ability. People v. Feinman, 77 Misc. 408, 137 N. Y. Supp. 933 (N. Y. City Ct. 1912).

Obtaining Credit Through False Representations.—Closely allied to the false financial statement law are the statutes which declare it unlawful to make knowingly a false statement *in writing* representing financial condition or ability to pay and upon reliance thereof to *obtain credit.*[43] These statutes require that the pretense must be in writing and signed by the party to be charged. This rule was dictated by the knowledge that "criminal charges of false pretenses are often instituted in reality to compel payment of a debt, and easily fabricated." [44]

New York has specifically enacted a statutory provision which makes an *oral* representation as described above not a criminal offense.[45] Nevertheless, where the accused orally affirmed the truth of a false statement of his financial status, even though made by another, conviction was upheld.[46] An identical result can be reached under one of the provisions of the typical false financial statement statute.[47] New York has also adopted a unique statute which requires that, where a buyer who purchases goods on the basis of a financial statement does not pay, the seller may within ninety days after default request the right to examine the buyer's books. The latter must allow this, and refusal to do so is presumptive evidence that the statement was false and so known to the buyer.[48] This statute has been held constitutional, and has been used to support a conviction in conjunction with a false financial statement.[49]

Protection of Certain Classes of Creditors.—Almost every state has adopted statutes which protect certain favored classes of persons from whom property was obtained by credit. The most widely adopted enactment of this type is the statute which provides that any person who obtains food, lodging, or other accommodation without paying therefor, with intent to defraud the inn-keeper, or obtains credit by means of a false pretense, is guilty of an offense.[50] Most states also provide that, if credit was obtained by a showing of baggage, any subsequent removal thereof without payment shall be presumptive evidence of an intent to defraud.[51] The protection of wage earners and mechanics lienholders has already been outlined above.[52]

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43. *E. g.*, PA. STAT. ANN., tit. 18, § 4838 (Purdon, 1945); People v. Lucas, 75 Ill. App. 662 (3d Dist. 1898) (purpose of the statute). A few states have adopted this law in lieu of the false financial statement statute. *E. g.*, COLO. STAT. ANN., c. 48, § 316 (1936). California provides that if credit is actually obtained, the offense is larceny; otherwise, it is merely a misdemeanor. CAL. PENAL CODE §§ 532, 532a (Deering, 1941); *accord*, Morris v. People, 4 Colo. App. 136, 35 Pac. 188 (1893) (insisting that value be actually obtained).

44. People v. Hyatt, 172 N. Y. 176, 65 N. E. 825 (1902).

45. N. Y. PENAL LAW § 947.

46. People v. Levin, 119 App. Div. 233, 104 N. Y. Supp. 647 (1907), *aff'd per cur.*, 194 N. Y. 554, 87 N. E. 1124 (1909).

47. The N. Y. statute so provides, see note 40 *supra;* see also PA. STAT. ANN., tit. 18, § 4839 (Purdon, 1945).

48. N. Y. PENAL LAW § 442.

49. People v. Mallon, 222 N. Y. 456, 119 N. E. 102 (1918).

50. *E. g.*, CAL. PENAL CODE § 537 (Deering, 1941); N. Y. PENAL LAW § 925; PA. STAT. ANN., tit. 18, § 4871 (Purdon, 1945).

51. *E. g.*, N. Y. PENAL LAW § 925. The law gives the hotel keeper a drastic remedy, in cases of actual fraud, against any effort to deprive him of his lien upon a guest's baggage. People v. Klas, 79 Misc. 452, 141 N. Y. Supp. 212 (Gen. Sess. 1913).

52. See notes 27 and 31 *supra* and text. The fictitious name statutes were adopted for the protection of those who might deal with, or give credit to a fictitious entity, or to a person dealing under an assumed name. The form of the statutes is generally to require registration of the name, and their nature is usually penal. See CREDIT MANUAL OF COMMERCIAL LAWS, *op. cit supra* note 40, at 357.

Worthless Check Laws.—The false pretense statutes have universally been supplemented with specific statutes relating to bad checks. While the details of the statutes differ, they are essentially the same in principle. Under them, a maker who issues, or a holder who negotiates a check with an intent to defraud, knowing that there are insufficient funds or credit behind it, is guilty of a crime.[53] A few jurisdictions retain the approach that some "property" actually must have been obtained through the use of the bad check.[54] In many states there is a provision that if the check be paid within a certain number of days after notice, prosecution of the drawer shall be abated,[55] but most commercial states do not so provide.

The intent to defraud is generally held to be an essential element of the crime even if the statute does not so require.[56] In Kansas, however, no intent at all is necessary.[57] Most of the statutes contain a provision to the effect that, in any prosecution, proof that the check was made or uttered by the accused, and payment refused by the drawee because of lack of funds or credit, establishes a prima facie case of intent to defraud and of knowledge of the insufficiency of the funds.[58] The strength that is given these laws by the raising of the presumption of intent to defraud cannot be overestimated. Only a few states still require that the intent to defraud be specifically proved;[59] the shifting of the burden of proof has done a great deal in making this law an effective deterrent sanction. In view of the tremendous volume of checks used every day, perhaps no other penal sanction has accomplished so much in recent times.

Straight Credit Sale

Where a seller of goods makes a *cash* sale and delivers them to the buyer conditioned on payment of the purchase price, conversion by the latter constitutes larceny, if done *animo furandi.*[60] But if one instant of *credit* is extended, the property becomes that of the buyer, and the obligation merely a debt.[61] Under such circumstances, the seller must rely heavily on the buyer's promise to pay and on the expectation that the buyer will preserve his property in the same or equivalent form. Criminal sanctions here cover only special situations.

The Making of a False Promise to Pay.—Where the buyer does not misrepresent his financial status in writing, but merely makes a promise

53. *E. g.*, N. Y. Penal Law § 1292-a; Pa. Stat. Ann., tit. 18, § 4854 (Purdon, 1945). Vermont provides no criminal liability but permits civil arrest of the maker of a check in the event the amount cannot be recovered by execution against the maker's property.

54. *E. g.*, Ill. Stat. Ann., c. 38, § 255 (Smith-Hurd, Supp. 1948). Under New York Penal Law § 1292-a, if property is actually obtained, the offense is larceny; otherwise, it is merely a misdemeanor.

55. Credit Manual of Commercial Laws, *op. cit. supra* note 40, at 340, 341. But see Pa. Stat. Ann., tit. 18, § 4854 (Purdon, 1945) wherein the presumption does not attach if payment is made within ten days.

56. Phillips v. State, 24 Ala. App. 456, 136 So. 480 (1931); Berry v. State, 153 Ga. 169, 111 S. E. 669 (1922). However, the Kentucky statute was held unconstitutional for failure to require the element of criminal intent. Burman v. Commonwealth, 228 Ky. 410, 15 S. W. 2d 256 (1929). For constitutional attacks on these laws as violating the prohibition of imprisonment for debt, see note 24 *supra.*

57. State v. Avery, 111 Kan. 588, 207 Pac. 838 (1922).

58. See statutes cited in note 53 *supra.* The Illinois statute raises the presumption only with regard to the intent to defraud. Ill. Ann. Stat., c. 38, § 255 (Smith-Hurd, Supp. 1948).

59. *E. g.*, People v. Becker, 137 Cal. App. 349, 30 P. 2d 562 (2d Dist. 1934).

60. The cases are collected in Note, 20 Col. L. Rev. 318 (1920).

61. People v. Noblett, 244 N. Y. 355, 155 N. E. 670 (1927).

to pay, *not intending to keep that promise at the time it is made,* the crime of false pretenses is not committed, according to the weight of authority.[62] The dogma is that there must be a representation of a past or existing fact.[63] Traditionally, the rule has had one modification: when the accused has made a false promise coupled with a misrepresentation of a past or present fact, conviction is proper even though the promise acted as an important part of the inducement.[64] A number of courts have extended this concept by holding that, in entering into the contract to buy goods, the buyer impliedly represents that he intends to pay for them (to be distinguished from orally representing his ability to pay); if such is not his intention, he may be found to have made a false representation.[65] So far as moral turpitude goes, a false promise is as bad as a false representation,[66] and since the seller depends almost entirely upon the good faith of the buyer, such reliance should be protected. These decisions, therefore, seem well founded. On the other hand, there is always the danger that a jury will use hindsight to find fraud at the inception of a contract merely because an honest debtor is now unable to pay.[67]

Fraudulent Conveyances.—Almost every jurisdiction has adopted a law based on the statute of 13 Elizabeth,[68] which made it a criminal offense to be a party to a fraudulent conveyance. The typical statute provides that every person who is a party to any conveyance, or transfer of any property, made with the intent to deceive, defraud, hinder or delay creditors is guilty of an offense.[69] Most such statutes contain additional provisions which forbid secreting or removing property to defraud creditors or to prevent levy.[70] The few decisions under these statutes, particularly recent ones, all construe them narrowly.[71] A definite attempt to defraud must be shown,[72] although it need not be directed toward a particular creditor.[73] The limitations suggested previously are particularly applicable here.[74]

62. *E. g.,* Chaplin v. United States, 157 F. 2d 697 (D. C. Cir. 1946).

63. *E. g.,* Rex v. Wheatley, 2 Burr. 1125, 97 Eng. Rep. 746 (K. B. 1761). See CLARK AND MARSHALL, A TREATISE ON THE LAW OF CRIMES 468 (4th ed. 1940). However, it was by judicial decision and not by the words of even the earliest statute that this dogma was required. See Comment, 21 TULANE L. REV. 639, 645 (1947).

64. Randle v. United States, 113 F. 2d 945 (D. C. Cir. 1940), *cert. denied,* 311 U. S. 683 (1940).

65. *E. g.,* State v. Huckins, 212 Iowa 283, 234 N. W. 554 (1931); Commonwealth v. Morrison, 252 Mass. 116, 147 N. E. 588 (1925); Commonwealth v. Walker, 108 Mass. 309 (1871); State v. McMahon, 49 R. I. 107, 140 Atl. 359 (1928).

66. See ORFIELD, *op. cit. supra* note 34, at 138.

67. Some writers express the opinion that the criminal rule of evidence requiring that there must be proof beyond a reasonable doubt may give adequate protection to the accused. See ORFIELD, *op. cit. supra* note 34, at 138. See also 34 HARV. L. REV. 557 (1921).

68. 13 ELIZ., c. 5 (1571). See 2 MOORE, FRAUDULENT CONVEYANCES 1061 (1908).

69. *E. g.,* CAL. PENAL LAW § 537 (Deering, 1941); N. Y. PENAL LAW § 1170.

70. *E. g.,* N. Y. PENAL LAW § 1171; PA. STAT. ANN., tit. 18, § 4886 (Purdon, 1945).

71. *E. g.,* State v. Marsh, 36 N. H. 196 (1858); Prough v. Entriken, 11 Pa. 81 (1849). It has been held not to apply to realty: People v. Police Justice, 41 Mich. 224, 2 N. W. 25 (1879); Commonwealth v. Markle, 1 York Legal Record 39 (Pa. Q. S. 1880).

72. For example, removal after levy may be larceny, Commonwealth v. Shertzer, 14 Lancaster L. Rev. 70 (Pa. Q. S. 1896); but where the accused merely moves to another home with no intent to conceal the goods, no offense is committed. Commonwealth v. Wenger, 35 Lancaster L. Rev. 304 (Pa. Q. S. 1918).

73. Loomis v. People, 19 Hun 601 (N. Y. 1880).

74. Prough v. Entriken, 11 Pa. 81, 84 (1849). Here it was noted, "The Act was intended to punish a criminal offense, not as a means of collecting debts, however just, and to suffer it to be perverted to that purpose will necessarily lead to great injustice and oppression."

Other statutes have been adopted in some states to protect the seller who relies solely on the credit of the purchaser. For example, Colorado makes it unlawful to purchase goods on credit, and thereafter, before paying for them, to sell or hypothecate them with fraudulent intent.[75] A similar statute punishes the credit buyer if he personally absconds from the state with intent to defraud the seller.[76]

Bulk Sales Law.—The demands of organized credit men throughout the nation have led to the enactment of the Bulk Sales Acts,[77] which generally require that a merchant give notice to his creditors of his intention to sell his stock or fixtures to another person.[78] The object of the notice is to give the creditor opportunity to determine whether the proposed transfer is to be made in good faith and for a consideration adequate to protect him. Even if notice is given, however, the sale may still be attacked as fraudulent. Under the New York law, there is no criminal provision; Pennsylvania requires that a statement listing all the vendor's creditors be given to the purchaser, and provides that any wilful delivery of an untrue or incomplete list is a misdemeanor.[79]

Fraudulent Insolvencies.—One of the most serious of all problems which face creditors is false or fraudulent insolvency. Since most of the cases arise under federal law, they are excluded from this Note. It may be pointed out, however, that bogus bankruptcies defraud creditors of more than half a billion dollars annually, while the total loss due to robbery, burglary, thievery, and the like amounts to less than four hundred million dollars.[80] The Credit Protection Department of the National Association of Credit Men raises and spends hundreds of thousands of dollars each year to prosecute commercial frauds, the majority of which is devoted to an attempt to curtail dishonest failures.[81]

Secured Sales

The complexities of security transactions make common law concepts of crime inadequate. Since the buyer generally wants the use of the goods during the credit period, possession of them under most of the security transactions must be in the purchaser. The common man's respect for other people's property is still bound up with the tangible, visible, corporeal element of possession.[82] Once that leaves, the criminal law begins to falter. Larceny, for example, protects only the possessory interest. Embezzlement and false pretenses are aimed at protecting the ownership of property, but are inadequate since, in sales transactions, "property" is a complex structure of part-way stages.[83] Running throughout the sale of goods wherever the seller attempts to secure himself is the difficult problem of

75. Colo. Stat. Ann., c. 48, § 311 (1936); *cf.* Nicholls v. McShane, 16 Colo. App. 165, 64 Pac. 375 (1901).

76. Colo. Stat. Ann., c. 48, § 312 (1936).

77. Credit Manual of Commercial Laws, *op. cit. supra* note 40, at 369.

78. *E. g.*, N. Y. Pers. Prop. Law § 44.

79. Pa. Stat. Ann., tit. 69, § 524 (Purdon, 1931).

80. Barnes and Teeters, New Horizons in Criminology 21 (1945).

81. Chapin, *op. cit. supra* note 38, at 500; Prendergast and Steiner, *op. cit. supra* note 1, at 630.

82. Mannheim, *op. cit. supra* note 6, at 100.

83. ". . . reference to the location of 'the property' in chattels as a key to determine issues is a farmer's reference, suited to a farmer's world. . . . The precise situation to which the 'property' is *not* suited is the situation of commerce-in-action . . . not static but in motion, not in one fist but in the spread interlocked fingers of at least two different hands. . . ." Llewellyn, *Across Sales on Horseback*, 52 Harv. L. Rev. 725, 732 (1930).

split ownership—of property as a bundle of legal incidents divided between buyer and seller. Each type of security transaction gives rise to special problems of protecting the seller.

Pledge.—One of the essential characteristics of the pledge is that the pledgee must have possession, and that the security is relinquished upon the loss of possession. Therefore, the most conceptual view of larceny will protect the pledgee-seller's security.

Consignment.—Since a consignment sale generally creates an agency relationship, the fraudulent conversion or broader embezzlement statutes would make criminal the conversion of the proceeds of the sale.[84] Even if the contract creates a *del credere* agency—where the consignee guarantees to the consignor that the buyers will pay the purchase price—the agent does not acquire the right to keep the money and to owe it merely as a debt; if he diverts it to his own use, it is embezzlement.[85]

Pennsylvania Bailment-Lease.—Prior to the adoption of the Uniform Conditional Sales Act in 1925, the chief security device in Pennsylvania was the so-called bailment-lease. Since title remains in the bailor and sale of the goods is technically not contemplated,[86] conversion of the property is criminal.[87] It has also been held that where the owner of goods is induced into parting with them under the terms of a bailment-lease, by trick or artifice, the offense amounts to larceny if done *animo furandi.*[88]

Conditional Sale.—In the conditional sale, possession of the goods is given to the purchaser, while title remains in the seller until the full purchase price is paid. The seller relies primarily on the tangible element of credit; he secures himself by retention of title in the goods conditionally sold. To be protected adequately, the seller must be assured that the buyer will not sell the goods and convert the proceeds, or remove them from the jurisdiction in which the seller may seize them on default. Since the buyer has secured possession of the goods lawfully, and has not obtained title by fraud, the common law crimes are inadequate to afford this protection. States which have failed to adopt remedial legislation have held that sale or removal of the goods is a mere breach of contract.[89] In most jurisdictions, however, it is made a crime to injure, destroy or conceal goods subject to a conditional sale, with the intent to defraud the seller, or to remove them from the filing district, or to sell, mortgage, or otherwise

84. Conviction has been obtained under an embezzlement by consignee statute. PA. STAT. ANN., tit. 18, § 4826 (Purdon, 1945), Commonwealth v. Winkel, 24 Pa. Dist. 404 (Q. S. 1915); but consignees have been held not guilty under the broadly construed larceny by bailee statute. People v. Gualano, 349 Ill. 235, 181 N. E. 643 (1932); People v. Feldstein, 273 Ill. App. 47 (1st Dist. 1933).

85. State v. McAvoy, 40 R. I. 437, 101 Atl. 109 (1917); Commonwealth v. Smith, 29 Schuylkill Legal Record 184 (Pa. Q. S. 1931).

86. S. F. Bowser & Co. v. Franklin Mortgage & Inv. Co., 305 Pa. 459, 158 Atl. 170 (1931) (if sale, rather than use, is contemplated, the transaction cannot be given the usual incidents of a bailment-lease).

87. Commonwealth v. Petres, 2 Somerset Legal Journal 296 (Pa. Q. S. 1924). What effect the *Williams* case has on such a decision is speculative. See note 117 *infra.*

88. Commonwealth v. Mendenhall, 20 Pa. D. & C. 227 (Q. S. 1934).

89. The Illinois statutes do not impose criminal liability on a conditional buyer who disposes of the goods held under a conditional sale contract with intent to defraud the seller. The Illinois Attorney General has expressed the opinion that the buyer in such a case cannot be prosecuted under the chattel mortgage penal sanctions, nor under the larceny by bailee statute. ILL. OPS. ATT'Y GEN. 380 (1928); *cf.* People v. Robinson, 352 Ill. 596, 186 N. E. 484 (1933).

dispose of them under a claim of ownership.[90] The Uniform Conditional Sales Act, adopted in nine states, has a similar provision.[91] The statutes generally require an intent to defraud the conditional seller, and it has been held that the mere resale of the goods before final payment is insufficient to establish a prima facie case.[92]

Chattel Mortgages.—Criminal sanctions are even more widely adopted in regard to mortgages on personalty. There are two types of statutes. The first makes it a crime to sell, conceal, or dispose of property subject to a mortgage with intent to defraud.[93] The other, more complex, makes it an offense to remove the property from the county with intent to defraud the mortgagee, and without his *written* consent. This latter statute also prohibits the sale of the goods without obtaining written permission from the mortgagee, and informing the prospective purchaser of the encumbrance.[94] While removal from the jurisdiction presents the same problem to the chattel mortgagee as it does to the conditional vendor, Pennsylvania makes such removal of mortgaged property operate only as a civil default.[95] Illinois, on the other hand, creates criminal liability in its chattel mortgage law, but refuses to extend it to conditional sales.[96] Texas, however, has drafted its chattel mortgage statute to bring the conditional sale within its purview.[97]

The cases decided under the statutes which forbid removal from the county usually require proof of an intent to defraud, to establish a prima facie case.[98] If the indictment is drawn, however, under the section of the statute which prohibits sale without the consent of the mortgagee and notice to the purchaser, cases are legion which hold that no intent to defraud need be alleged or proved; proof of the commission of the forbidden act constitutes a prima facie case.[99] Once the act is done, neither subsequent payment [100] nor agreement with the mortgagee [101] is a defense to prosecution.

Trust Receipt.—The pure trust receipt device, widely used in financing such items as automobiles, is *sui generis* in that full legal title is derived by the entruster (usually a bank or finance company) directly from the original seller to whom the entruster pays the purchase price.[102] The

90. *E. g.*, N. Y. PERS. PROP. LAW § 75; PA. STAT. ANN., tit. 69, § 433 (Purdon, 1945).
91. UNIFORM CONDITIONAL SALES ACT § 15.
92. Commonwealth v. Reed, 150 Mass. 67, 22 N. E. 434 (1889). *But cf.* People v. Gluck, 188 N. Y. 167, 80 N. E. 1022 (1907).
93. N. Y. PENAL LAW § 940.
94. *E. g.*, CAL. PENAL CODE § 538 (Deering, 1941).
95. PA. STAT. ANN., tit. 21, § 940.7 (Purdon, Supp. 1948).
96. See note 89 *supra.*
97. TEX. PENAL CODE, Arts. 1556, 1557, 1558 (Vernon, Supp. 1948).
98. People v. Wolfrom, 15 Cal. App. 732, 115 Pac. 1088 (1st Dist. 1911); People v. Staton, 79 App. Div. 634, 80 N. Y. Supp. 2 (2d Dep't 1903). However, in Michigan, at least the language of the statute does not require such proof: MICH. STAT. ANN. § 28.649 (Callaghan, 1938).
99. People v. Phillips, 30 Cal. App. 31, 157 Pac. 1003 (2d Dist. 1916); Crosswhite v. People, 110 Colo. 584, 137 P. 2d 399 (1943); Commonwealth v. Cutler, 153 Mass. 252, 26 N. E. 855 (1891) (where the statutes required no intent); Bower v. Borland, 257 Mich. 306, 241 N. W. 201 (1932) (where a presumption was raised).
100. People v. Iden, 24 Cal. App. 627, 142 Pac. 117 (2d Dist. 1914).
101. Nall v. State, 133 Tex. Cr. Rep. 146, 109 S. W. 2d 492 (1937).
102. The pure trust receipt is unique in this respect. Use in domestic transactions, however, has led to considerable deviation from the pure transaction. In the so-called two-party trust receipt, the financer owns the goods in its own right. See Hanna, *Trust Receipts,* 29 COL. L. REV. 545 (1929). This apparently would have made some difference, but UNIFORM TRUST RECEIPTS ACT § 2 removes any distinction in regard to the source of title as long as the described situation is reached. Gilmore, *Chattel Security: II,* 57 YALE L. J. 761, 765 (1948).

seller-entruster delivers the goods directly to the dealer, who executes a trust receipt whereby he agrees to hold the goods in trust. The Uniform Trust Receipts Act contains no criminal provisions, and the states have failed to provide specific criminal protection.[103] Since the sale of the goods by the trustee-dealer is within the contemplation of the parties, the danger to the entruster is that the dealer will convert the proceeds.

Pennsylvania Trust Receipt Situation.—Although the trust receipt was first recognized in Pennsylvania as far back as 1894,[104] the conversion of the proceeds derived from the sale of goods is still not considered criminal. Prior to 1928, two lower court decisions had held dealers guilty of fraudulent conversion when proceeds were withheld under a trust receipt arrangement.[105] In *Commonwealth v. Williams,*[106] however, the Pennsylvania Superior Court announced a different rule. The facts of the case presented a typical trust receipt transaction; the indictment was drawn under the larceny by bailee statute, for the conversion of several automobiles. Although the agreement stipulated that the cars were not to be sold, the conduct of both parties showed clearly that the sale of the automobiles was contemplated by the entruster. It was the failure to account for the proceeds, not the sale of the cars, which motivated the criminal prosecution. Reversing the conviction, however, the appellate court said that the real purpose of the transaction was merely to secure payment for the *loan* made to the accused. Noting that the cars were to be sold by the accused and the proceeds paid to the finance company, it pointed out that the latter never was in possession of the cars, and that it never was intended that they be returned.[107] While the argument aims primarily at negativing the existence of a bailment, the implication is clear that the court thought the accused merely owed the finance company a debt. Although the holding might be narrowed to announce the inapplicability of the larceny by bailee statute to this factual situation, the whole tenor of the opinion makes it probable that conviction for conversion of the proceeds will be impossible under any present Pennsylvania criminal statute.

No reported case since 1928 has been found involving this point; however, the issue was presented squarely in an unreported case in Philadelphia County.[108] There the indictment was framed under the fraudulent conversion statute. The evidence showed that the defendant had sold automobiles held under a trust receipt arrangement and had converted the proceeds to his own use. On demurrer to the evidence, the court considered the *Williams* case controlling and directed a verdict of acquittal, holding that the relationship between the parties was that of debtor and creditor.

Assignment of Accounts Receivable.—A lien on proceeds exists where a seller of goods assigns an account receivable to a financer, but, in order to retain the good will of his customers, undertakes to collect them him-

103. While many states provide that embezzlement by a trustee is a crime, this statute has not been used in connection with the trust receipt device since the Uniform Trust Receipts Act specifically provides that the "trustee" shall be considered such *only* for the purposes of the Act itself.

104. Brown Bros. & Co. v. Billington, 163 Pa. 76, 29 Atl. 904 (1894).

105. Commonwealth v. Richley, 41 York Legal Record 17 (Pa. Q. S. 1927); Commonwealth v. Miller, 18 Schuylkill Legal Record 401 (Pa. Q. S. 1922); *cf.* Commonwealth v. Wooden, 94 Pa. Super. 452 (1928).

106. 93 Pa. Super. 92 (1928).

107. *Id.* at 100.

108. Commonwealth v. Kerbeck, No. 835, Pa. Q. S., Oct. 17, 1939.

self.[109] In such a situation, criminal liability depends upon the agreement between the parties. If the assignor is to hold the money in a separate account for the financer, or is to indorse checks received to that account, he may be held criminally responsible for the misappropriation of such funds.[110] On the other hand, where the agreement provides that the money may be placed in the assignor's own account, and settlement is made periodically, use of such funds is not criminal. The determinative factor should be the use to which the funds may be put, not the mere fact that settlement is to be made periodically. Under the doctrine of *Benedict v. Ratner*,[111] if the use of the collected proceeds by the assignor is "unfettered," the assignment is fraudulent at law. This test is also applicable to the issue of criminal responsibility for conversion.[112] Even where the contract calls for the money to be placed in a separate account, continued acquiescence by the financer to an exercise of dominion over the funds by the assignor should preclude any protection from the criminal law.

CONCLUSION

Extension of the criminal law to protect credit has been attacked by those who fear its use as a mere collection process. Clearly, however, modern business dealings must receive some such protection. As the result of steady pressure, many state statutes today attempt to deter dishonesty among buyers of goods on credit.[113] One major defect, however, is revealed by an examination of existing law. Although it is a crime for the conditional vendee to so much as remove the secured property out of the county, he is exculpated if he sells the property with the consent of the vendor and converts the proceeds.[114] A mortgagor who sells the encumbranced property without authority may be imprisoned, but if he sells the property with the consent of the mortgagee and fraudulently withholds the proceeds, he cannot be prosecuted.[115] Likewise, where property is subject to a trust receipt arrangement contemplating sale by the "trustee," and the latter converts the proceeds of that sale, he is only a debtor.[116]

In most instances, the reservation of title in the goods is afforded protection. But when title to those goods is transferred to a bona fide purchaser, the courts are usually unwilling to find a property interest in the proceeds of the sale, and refuse to impose criminal liability when the holder converts them to his own use. Where the agreement between the parties is such that the buyer may use the proceeds derived from the resale of the seller's goods, and merely must account periodically to the seller, the seller loses whatever property interest he had and becomes a mere creditor. Similarly, where continued practice or custom between the parties allows

109. This is the so-called assignment on a non-notification basis; its use is fully discussed in SAULNIER AND JACOBY, ACCOUNTS RECEIVABLE FINANCING (1943) *passim*. See also Koessler, *Assignment of Accounts Receivable*, 33 CALIF. L. REV. 40 (1945).

110. State v. Parker, 112 Conn. 39, 151 Atl. 325 (1930); State v. Carmean, 126 Iowa 291, 102 N. W. 97 (1905); *cf.* Commonwealth v. Willstein, 146 Pa. Super. 357, 22 A. 2d 613 (1941) (assignment of a judgment for collection).

111. 268 U. S. 353 (1925).

112. For the application of the "unfettered use" doctrine to this situation, see Taylor, *The Collection of Accounts Receivable*, 25 MINN. L. REV. 201, 202 (1941).

113. Compare the effect that criminal sanctions of the state Blue Sky Laws have had as a deterrent force; see MICHAEL AND WECHSLER, *op. cit. supra* note 22, at 468. ". . . nothing so much instills fear into the minds of fraudulent stock operators as criminal prosecution." REP. ATT'Y GEN. N. Y. 49 (1933).

114. State v. Sheets, 217 Ind. 676, 30 N. E. 2d 309 (1940).

115. Dempsey v. State, 94 Ga. 766, 22 S. E. 57 (1894) (title state); Daniels v. State, 100 Tex. Cr. Rep. 493, 272 S. W. 143 (1925) (lien state).

116. Commonwealth v. Kerbeck, No. 835, Pa. Q. S., Oct. 17, 1939.

the buyer to handle the funds as his own, notwithstanding a contract to the contrary, the buyer cannot be held criminally liable for misuse of the funds or for insolvency. Where the parties themselves, however, agree that title is to remain in the seller or financer, and where no third party claimants are involved, the agreement should be controlling. Criminal sanctions are needed where the contract between the buyer and seller admits a property interest in the latter, and calls for an immediate accounting of the proceeds on resale. The same penalties which are imposed to protect the seller's interest in the goods should be extended to safeguard the interest he has in the proceeds.

In the eighteenth century the law of larceny faced a similar problem in the narrowness of the concept of possession,[117] which was overcome only by the enactment of remedial legislation. Today an equally conceptual notion of "property" has led our courts to pronounce the proceeds from the sale of the seller's goods a mere debt. It is submitted that such decisions give carte blanche to a thief and allow him to operate within the law. The consignee who converts the proceeds from the sale of the consignor's goods is guilty of embezzlement.[118] Is the difference merely that in this transaction the converter is called an agent—a familiar common law concept?

Progress has been made by states which have adopted the consolidated theft statutes.[119] Procedurally, at least, they have freed themselves from the web of refined distinctions among the traditional commercial crimes. A suitable substitute is the so-called fraudulent conversion statute which provides that any person in possession, in any capacity, of goods belonging to any other person, or which that person is entitled to receive, who fraudulently converts or withholds said goods *or the proceeds derived from the sale thereof*, is guilty of a crime.[120] Although Pennsylvania has adopted this statute, it has not been used to full advantage.[121]

Today it is difficult to imagine a society in which the law provided no penalty for the swindler who obtained property by false pretenses, but at the same time imprisoned an indigent laborer who failed to pay promptly for his family's bread. Somewhere between these two extremes lies an avenue where credit transactions can be protected properly, without a commercially depressing effect. Penalizing dishonest conduct to preserve the credit economy benefits society as a whole, since the seeker of credit himself would suffer most if credit sales were abated or curtailed because of insufficient legal protection. But as long as the criminal law is based on a conception of property which was formed in an immobile agricultural economy, it must inevitably be inadequate.[122] Criminal sanctions based on a concept of "commerce-in-action" have been, and can be, a vital aid in actually fostering a complex credit economy.

A. N. R., Jr.

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117. See note 10 *supra* and text.

118. See note 85 *supra* and text.

119. *E. g.*, CALIF. PENAL CODE § 484 (Deering, 1941); N. Y. PENAL LAW § 1290.

120. *E. g.*, PA. STAT. ANN., tit. 18, § 4834 (Purdon, 1945). Illinois has given its larceny by bailee statute a very broad interpretation, perhaps broad enough to cover the conversion of proceeds. ILL. ANN. STAT., tit. 38, § 394 (Smith-Hurd, 1935); *cf.* People v. Barnard, 327 Ill. 305, 158 N. E. 729 (1927); Bergman v. People, 177 Ill. 244, 52 N. E. 363 (1898).

121. *E. g.*, Commonwealth v. Mitchneck, 130 Pa. Super. 433, 198 Atl. 463 (1938); Commonwealth v. Hillpot, 84 Pa. Super. 454 (1925).

122. See MANNHEIM, *op. cit. supra* note 6, at 99.